

(To establish a petty cash fund)

A	=	L	+	SE
+100				
-100				

Cash Flows

no effect

The fund custodian cashes the check and places the proceeds in a locked petty cash box or drawer. Most petty cash funds are established on a fixed-amount basis. Moreover, the company will make no additional entries to the Petty Cash account unless the stipulated amount of the fund is changed. For example, if Laird Company decides on July 1 to increase the size of the fund to \$250, it would debit Petty Cash \$150 and credit Cash \$150.

Ethics Note

Petty cash funds are authorized and legitimate. In contrast, “slush” funds are unauthorized and hidden (under the table).

MAKING PAYMENTS FROM PETTY CASH

The custodian of the petty cash fund has the authority to make payments from the fund that conform to prescribed management policies. Usually, management limits the size of expenditures that come from petty cash and does not permit use of the fund for certain types of transactions (such as making short-term loans to employees).

Helpful Hint

From the standpoint of internal control, the receipt satisfies two principles: (1) establishing responsibility (signature of custodian), and (2) documentation procedures.

Each payment from the fund must be documented on a prenumbered petty cash receipt (or petty cash voucher). The signatures of both the custodian and the individual receiving payment are required on the receipt. If other supporting documents such as a freight bill or invoice are available, they should be attached to the petty cash receipt.

The custodian keeps the receipts in the petty cash box until the fund is replenished. As a result, the sum of the petty cash receipts and money in the fund should equal the established total at all times. This means that management can make surprise counts at any time by an independent person, such as an internal auditor, to determine the correctness of the fund.

The company does not make an accounting entry to record a payment at the time it is taken from petty cash. It is considered both inexpedient and unnecessary to do so. Instead, the company recognizes the accounting effects of each payment when the fund is replenished.

REPLENISHING THE PETTY CASH FUND

When the money in the petty cash fund reaches a minimum level, the company replenishes the fund. The petty cash custodian initiates a request for reimbursement. This individual prepares a schedule (or summary) of the payments that have been made and sends the schedule, supported by petty cash receipts and other documentation, to the treasurer's office. The receipts and supporting documents are examined in the treasurer's office to verify that they were proper payments from the fund. The treasurer then approves the request, and a check is prepared to restore the fund to its established amount. At the same time, all supporting documentation is stamped "paid" so that it cannot be submitted again for payment.


Helpful Hint

Replenishing involves three internal control procedures: segregation of duties, documentation procedures, and independent internal verification.

To illustrate, assume that on March 15 the petty cash custodian requests a check for \$87. The fund contains \$13 cash and petty cash receipts for postage \$44, supplies \$38, and miscellaneous expenses \$5. The entry, in general journal form, to record the check is:

Mar. 15	Postage Expense	44
	Supplies	38
	Miscellaneous Expense	5
	Cash	87


(To replenish petty cash fund)

A	=	L	+	SE
				-44 Exp
+38				-5 Exp
-87				
<hr/>				
Cash Flows				
-87				

Note that the reimbursement entry does not affect the Petty Cash account. Replenishment changes the composition of the fund by replacing the petty cash receipts with cash, but it does not change the balance in the fund.

Occasionally, in replenishing a petty cash fund the company may need to recognize a cash shortage or overage. To illustrate, assume in the preceding example that the custodian had only \$12 in cash in the fund plus the receipts as

listed. The request for reimbursement would therefore be for \$88, and the following entry would be made.
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A	=	L	+	SE	
					-44 Exp
+38					-5 Exp
					-1 Exp
-88					
<hr/>					
Cash Flows					
-88					

Mar. 15	Postage Expense	44
	Supplies	38
	Miscellaneous Expense	5
	Cash Over and Short	1
	Cash	88

(To replenish petty cash fund)

Conversely, if the custodian had \$14 in cash, the reimbursement request would be for \$86, and Cash Over and Short would be credited for \$1. A debit balance in Cash Over and Short is reported in the income statement as miscellaneous expense; a credit balance is reported as miscellaneous revenue. The company closes Cash Over and Short to Income Summary at the end of the year.

Companies should replenish a petty cash fund **at the end of the accounting period, regardless of the cash in the fund**. Replenishment at this time is necessary in order to recognize the effects of the petty cash payments on the financial statements.

Internal control over a petty cash fund is strengthened by (1) having a supervisor make surprise counts of the fund to ascertain whether the paid petty cash receipts and fund cash equal the designated amount, and (2) canceling or mutilating the paid petty cash receipts so they cannot be resubmitted for reimbursement.

Summary of Learning Objective for Appendix 7A

9 Explain the operation of a petty cash fund. In operating a petty cash fund, a company establishes the fund by appointing a custodian and determining the size of the fund. The custodian makes payments from the fund for documented expenditures. The company replenishes the fund as needed, and at the end of each accounting period. Accounting entries to record payments are made each time the fund is replenished.

Glossary

Bank reconciliation

(p. 352) The process of comparing the bank's account balance with the company's balance, and explaining the differences to make them agree.

Bank statement

(p. 352) A statement received monthly from the bank that shows the depositor's bank transactions and balances.

Bonding

(p. 344) Obtaining insurance protection against theft by employees.

Cash

(p. 358) Resources that consist of coins, currency, checks, money orders, and money on hand or on deposit in a bank or similar depository.

Cash budget

(p. 362) A projection of anticipated cash flows, usually over a one- to two-year period.

Cash equivalents

(p. 359) Short-term, highly liquid investments that can be readily converted to a specific amount of cash and which are relatively insensitive to interest rate changes.

Deposits in transit

(p. 355) Deposits recorded by the depositor that have not been recorded by the bank.

Electronic funds transfer (EFT)

(p. 357) A disbursement system that uses wire, telephone, or computer to transfer cash from one location to another.

Fraud

(p. 336) A dishonest act by an employee that results in personal benefit to the employee at a cost to the employer.

Fraud triangle

(p. 336) The three factors that contribute to fraudulent activity by employees: opportunity, financial pressure, and rationalization.

Internal auditors

(p. 344) Company employees who continuously evaluate the effectiveness of the company's internal control systems.

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(p. 337) All the related methods and measures adopted within an organization to safeguard assets and enhance the reliability of accounting records, increase efficiency of operations, and ensure compliance with laws and regulations.

NSF check

(p. 352) A check that is not paid by a bank because of insufficient funds in a bank account.

Outstanding checks

(p. 355) Checks issued and recorded by a company that have not been paid by the bank.

Petty cash fund

(p. 351) A cash fund used to pay relatively small amounts.

Restricted cash

(p. 359) Cash that is not available for general use but instead is restricted for a particular purpose.

Sarbanes-Oxley Act (SOX)

(p. 337) Law that requires publicly traded companies to maintain adequate systems of internal control.

Treasurer

(p. 361) Employee responsible for the management of a company's cash.

Voucher

(p. 350) An authorization form prepared for each expenditure in a voucher system.

Voucher system

(p. 350) A network of approvals by authorized individuals, acting independently, to ensure that all disbursements by check are proper.

Comprehensive

Trillo Company's bank statement for May 2014 shows these data.

Balance May 1	\$12,650	Balance May 31	\$14,280
Debit memorandum:		Credit memorandum:	
NSF check	175	Collection of note receivable plus interest	505

The cash balance per books at May 31 is \$13,319. Your review of the data reveals the following.

- 1. The NSF check was from Hup Co., a customer.

2. The note collected by the bank was a \$500, 3-month, 12% note. The bank charged a \$10 collection fee. No interest has been previously accrued.

- 3. Outstanding checks at May 31 total \$2,410.
- 4. Deposits in transit at May 31 total \$1,752.
- 5. A Trillo Company check for \$352 dated May 10 cleared the bank on May 25. This check, which was a payment on account, was journalized for \$325.

Instructions

- (a) Prepare a bank reconciliation at May 31.
- (b) Journalize the entries required by the reconciliation.

Action Plan

- ● Follow the four steps used in reconciling items ([p. 355](#)).
- ● Work carefully to minimize mathematical errors in the reconciliation.
- ● Prepare entries based on reconciling items per books.
- ● Make sure the cash ledger balance after posting the reconciling entries agrees with the adjusted cash balance per books.

Solution to Comprehensive



- (a)

Cash balance per bank statement	\$14,280
Add: Deposits in transit	<u>1,752</u>
	16,032
Less: Outstanding checks	<u>2,410</u>
Adjusted cash balance per bank	\$13,622
Cash balance per books	\$13,319
Add: Collection of note receivable \$500, plus \$15 interest less collection fee \$10	<u>505</u>
	13,824
Less: NSF check	\$175
Error in recording check	<u>27</u> <u>202</u>

- (b)

May 31 Cash 505

Miscellaneous Expense 10

Notes Receivable 500

Interest Revenue 15

(To record collection of note by bank)

31 Accounts Receivable—Hup Co. 175

Cash 175

(To record NSF check from Hup Co.)

31 Accounts Payable 27

Cash 27

(To correct error in recording check)



WileyPLUS

Self-Test, Brief Exercises, Exercises, Problem Set A, and many more resources are available for practice in WileyPLUS.

Note: All Questions, Exercises, and Problems marked with an asterisk relate to material in the appendix to the chapter.

Self-Test Questions

Answers are on [page 393](#).

1. **PRINTED BY: jromero0950@email.phoenix.edu. Printing is for personal, private use only. No part of this book may be reproduced or transmitted without publisher's prior permission. Violators will be prosecuted.**
Which of the following is **not** an element of the fraud triangle?

(LO 1)

- (a) Rationalization.
- (b) Financial pressure.
- (c) Segregation of duties.
- (d) Opportunity.

2.

Internal control is used in a business to enhance the accuracy and reliability of its accounting records and to:

(LO 1)

- (a) safeguard its assets.
- (b) create fraud.
- (c) analyze financial statements.
- (d) determine employee bonuses.

3.



The principles of internal control do **not** include:

(LO 2)

- (a) establishment of responsibility.
- (b) documentation procedures.
- (c) financial performance measures.
- (d) independent internal verification.

4.

Physical controls do **not** include:

(LO 2)

- (a) safes and vaults to store cash.
- (b) independent bank reconciliations.
- (c) locked warehouses for inventories.
- (d) bank safety deposit boxes for important papers.

5.

Which of the following was **not** a result of the Sarbanes-Oxley Act?

(LO 1)

- (a) Companies must file financial statements with the Internal Revenue Service.
- (b) All publicly traded companies must maintain adequate internal controls.
- (c) The Public Company Accounting Oversight Board was created to establish auditing standards and regulate auditor activity.
- (d) Corporate executives and boards of directors must ensure that controls are reliable and effective, and they can be fined or imprisoned for failure to do so.

6.

Permitting only designated personnel such as cashiers to handle cash receipts is an application of the principle of internal control. **PRINTED BY: jromero0950@email.phoenix.edu. Printing is for personal, private use only. No part of this book may be reproduced or transmitted without publisher's prior permission. Violators will be prosecuted.**

(LO 3)

- (a) documentation procedures.
- (b) establishment of responsibility.
- (c) independent internal verification.
- (d) other controls.

7.

The use of prenumbered checks in disbursing cash is an application of the principle of:

(LO 4)

- (a) establishment of responsibility.
- (b) segregation of duties.
- (c) physical controls.
- (d) documentation procedures.

8.

The control features of a bank account do **not** include:

(LO 4)

- (a) having bank auditors verify the correctness of the bank balance per books.
- (b) minimizing the amount of cash that must be kept on hand.
- (c) providing a double record of all bank transactions.
- (d) safeguarding cash by using a bank as a depository.

9.

Which of the following control activities is **not** relevant when a company uses a computerized (rather than manual) accounting system?

(LO 2)

- (a) Establishment of responsibility.
- (b) Segregation of duties.
- (c) Independent internal verification.
- (d) All of these control activities are relevant to a computerized system.

10.

In a bank reconciliation, deposits in transit are:

(LO 5)

- (a) deducted from the book balance.
- (b) added to the book balance.
- (c) added to the bank balance.
- (d) deducted from the bank balance.

11.

Which of the following items in a cash drawer at November 30 is **not** cash?

(LO 6)

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- (a) Money orders.
- (b) Coins and currency.
- (c) A customer check dated December 1.
- (d) A customer check dated November 28.

12.



Which statement correctly describes the reporting of cash?

(LO 6)

- (a) Cash cannot be combined with cash equivalents.
- (b) Restricted cash funds may be combined with cash.
- (c) Cash is listed first in the current assets section.
- (d) Restricted cash funds cannot be reported as a current asset.

13.

Which of the following would **not** be an example of good cash management?

(LO 7)

- (a) Provide discounts to customers to encourage early payment.
- (b) Invest temporary excess cash in stock of a small company.
- (c) Carefully monitor payments so that payments are not made early.
- (d) Employ just-in-time inventory methods to keep inventory low.

14.



Which of the following is **not** one of the sections of a cash budget?

(LO 8)

- (a) Cash receipts section.
- (b) Cash disbursements section.
- (c) Financing section.
- (d) Cash from operations section.

*15.

A check is written to replenish a \$100 petty cash fund when the fund contains receipts of \$94 and \$2 in cash. In recording the check:

(LO 9)

- (a) Cash Over and Short should be debited for \$4.
- (b) Petty Cash should be debited for \$94.
- (c) Cash should be credited for \$94.
- (d) Petty Cash should be credited for \$4.

Go to the book's companion website, www.wiley.com/college/kimmel, to access additional Self-Test Questions.



Questions

1.

A local bank reported that it lost \$150,000 as the result of employee fraud. Fred Raburn is not clear on what is meant by "employee fraud." Explain the meaning of fraud to Fred and give an example of fraud that might occur at a bank.


2.

Fraud experts often say that there are three primary factors that contribute to employee fraud. Identify the three factors and explain what is meant by each.

3.

Identify the five components of a good internal control system.

4.

 "Internal control is concerned only with enhancing the accuracy of the accounting records." Do you agree? Explain.

5.

Discuss how the Sarbanes-Oxley Act has increased the importance of internal control to top managers of a company.

6.

What principles of internal control apply to most businesses?

7.

In the corner grocery store, all sales clerks make change out of one cash register drawer. Is this a violation of internal control? Why?

8.

Donald Bowen is reviewing the principle of segregation of duties. What are the two common applications of this principle?

9.

How do documentation procedures contribute to good internal control?

10.

What internal control objectives are met by physical controls?

11.

- (a) Explain the control principle of independent internal verification.
- (b) What practices are important in applying this principle?



As the company accountant, explain the following ideas to the management of Jurgens Company.

- (a) The concept of reasonable assurance in internal control.
- (b) The importance of the human factor in internal control.

13.



Discuss the human resources department's involvement in internal controls.

14.

Hoskins Inc. owns the following assets at the balance sheet date.

Cash in bank—savings account	\$ 8,000
Cash on hand	1,100
Cash refund due from the IRS	1,000
Checking account balance	12,000
Postdated checks	500

What amount should be reported as Cash in the balance sheet?

15.

What principle(s) of internal control is (are) involved in making daily cash counts of over-the-counter receipts?

16.

Assume that **Kohl's Department Stores** installed new cash registers in its stores. How do cash registers improve internal control over cash receipts?

17.

At Solis Wholesale Company, two mail clerks open all mail receipts. How does this strengthen internal control?

18.

“To have maximum effective internal control over cash disbursements, all payments should be made by check.” Is this true? Explain.

19.

Napoli Company's internal controls over cash disbursements provide for the treasurer to sign checks imprinted by a checkwriter after comparing the check with the approved invoice. Identify the internal control principles that are present in these controls.

20.

How do these principles apply to cash disbursements?

- (a) Physical controls.
- (b) Human resource controls.

21.

What is the essential feature of an electronic funds transfer (EFT) procedure?

22.

“The use of a bank contributes significantly to good internal control over cash.” Is this true? Why?

23.

Chris Hite is confused about the lack of agreement between the cash balance per books and the balance per bank. Explain the causes for the lack of agreement to Chris and give an example of each cause.

24.



Identify the basic principles of cash management.

25.

Marcia Tague asks your help concerning an NSF check. Explain to Marcia (a) what an NSF check is, (b) how it is treated in a bank reconciliation, and (c) whether it will require an adjusting entry on the company's books.

26.



- (a) Describe cash equivalents and explain how they are reported.
- (b) How should restricted cash funds be reported on the balance sheet?

27.



What was **Tootsie Roll's** balance in cash and cash equivalents at December 31, 2011? Did it report any restricted cash? How did Tootsie Roll define cash equivalents?

*28.

- (a) Identify the three activities that pertain to a petty cash fund, and indicate an internal control principle that is applicable to each activity.
- (b) When are journal entries required in the operation of a petty cash fund?

Brief Exercises

Identify fraud-triangle concepts.

(LO 1), C

- (a) An employee's monthly credit card payments are nearly 75% of their monthly earnings.
- (b) An employee earns minimum wage at a firm that has reported record earnings for each of the last five years.
- (c) An employee has an expensive gambling habit.
- (d) An employee has check writing and signing responsibilities for a small company, and is also responsible for reconciling the bank account.

BE7-2 Beth Pitchford is the new owner of Brigham Co. She has heard about internal control but is not clear about its importance for her business. Explain to Beth the four purposes of internal control, and give her one application of each purpose for Brigham Co.

Explain the importance of internal control.

(LO 2), C 

BE7-3 The internal control procedures in Edmiston Company make the following provisions. Identify the principles of internal control that are being followed in each case.

Identify internal control principles.

(LO 2), C

- (a) Employees who have physical custody of assets do not have access to the accounting records.
- (b) Each month, the assets on hand are compared to the accounting records by an internal auditor.
- (c) A prenumbered shipping document is prepared for each shipment of goods to customers.

BE7-4 Halleran Company has the following internal control procedures over cash receipts. Identify the internal control principle that is applicable to each procedure.

Identify the internal control principles applicable to cash receipts.

(LO 3), C

- (a) All over-the-counter receipts are entered in cash registers.
- (b) All cashiers are bonded.
- (c) Daily cash counts are made by cashier department supervisors.
- (d) The duties of receiving cash, recording cash, and having custody of cash are assigned to different individuals.
- (e) Only cashiers may operate cash registers.

BE7-5 While examining cash receipts information, the accounting department determined the following information: opening cash balance \$150, cash on hand \$1,125.74, and cash sales per register tape \$988.62. Prepare the required journal entry based upon the cash count sheet.

Make journal entry using cash count sheet.

(LO 3), AP

BE7-6 Catt Company has the following internal control procedures over cash disbursements. Identify the internal control principle that is applicable to each procedure.

Identify the internal control principles applicable to cash disbursements.

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(LO 4), C

- (a) Company checks are prenumbered.
- (b) The bank statement is reconciled monthly by an internal auditor.
- (c) Blank checks are stored in a safe in the treasurer's office.
- (d) Only the treasurer or assistant treasurer may sign checks.
- (e) Check-signers are not allowed to record cash disbursement transactions.

BE7-7 Roy Luber is uncertain about the control features of a bank account. Explain the control benefits of (a) a checking account and (b) a bank statement.

Identify the control features of a bank account.

(LO 4), C

BE7-8 The following reconciling items are applicable to the bank reconciliation for Nuessen Co. Indicate how each item should be shown on a bank reconciliation.

Indicate location of reconciling items in a bank reconciliation.

(LO 5), C

- (a) Outstanding checks.
- (b) Bank debit memorandum for service charge.
- (c) Bank credit memorandum for collecting a note for the depositor.
- (d) Deposit in transit.

BE7-9 Using the data in **BE7-8**, indicate (a) the items that will result in an adjustment to the depositor's records and (b) why the other items do not require adjustment.

Identify reconciling items that require adjusting entries.

(LO 5), C

BE7-10 At July 31, Farmer Company has this bank information: cash balance per bank \$7,291; outstanding checks \$762; deposits in transit \$1,350; and a bank service charge \$40. Determine the adjusted cash balance per bank at July 31.

Prepare partial bank reconciliation.

(LO 5), AP

BE7-11 In the month of November, Halladay Company Inc. wrote checks in the amount of \$9,750. In December, checks in the amount of \$11,762 were written. In November, \$8,800 of these checks were presented to the bank for payment, and \$10,889 in December. What is the amount of outstanding checks at the end of November? At the end of December?

Analyze outstanding checks.

(LO 5), AP

BE7-12 Span Company has these cash balances: cash in bank \$12,742; payroll bank account \$6,000; and plant expansion fund cash \$25,000. Explain how each balance should be reported on the balance sheet.

Explain the statement presentation of cash balances.

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BE7-13 The following information is available for Conger Company for the month of January: expected cash receipts \$59,000; expected cash disbursements \$67,000; and cash balance on January 1, \$12,000. Management wishes to maintain a minimum cash balance of \$9,000. Prepare a basic cash budget for the month of January.

Prepare a cash budget.


(LO 8),  **AP**

***BE7-14** On March 20, Garber's petty cash fund of \$100 is replenished when the fund contains \$19 in cash and receipts for postage \$40, supplies \$26, and travel expense \$15. Prepare the journal entry to record the replenishment of the petty cash fund.

Prepare entry to replenish a petty cash fund.

(LO 9), **AP**


Do it! Review

 **Do it!** **7-1** Identify which control activity is violated in each of the following situations, and explain how the situation creates an opportunity for fraud or inappropriate accounting practices.

Identify violations of control activities.


(LO 2), **C**

- **1.** Once a month, the sales department sends sales invoices to the accounting department to be recorded.
- **2.** Nick Sewell orders merchandise for Silo Company; he also receives merchandise and authorizes payment for merchandise.
- **3.** Several clerks at Guillen's Groceries use the same cash register drawer.

 **Do it!** **7-2** Jack Woodling is concerned with control over mail receipts at Yount Sporting Goods. All mail receipts are opened by Bill Morten. Bill sends the checks to the accounting department, where they are stamped "For Deposit Only." The accounting department records and deposits the mail receipts weekly. Jack asks your help in installing a good system of internal control over mail receipts.

Design system of internal control over cash receipts.

(LO 3), **C**

 **Do it!** **7-3** Doug Nicklas owns Doug Blankets. Doug asks you to explain how he should treat the following reconciling items when reconciling the company's bank account.

Explain treatment of items in bank reconciliation.

(LO 5), **K**

- **1.** Outstanding checks
- **2.** A deposit in transit
- **3.** The bank charged to our account a check written by another company

Do it!

7-4 Hull Corporation's management wants to maintain a minimum monthly cash balance of \$8,000. At the beginning of September, the cash balance is \$12,270; expected cash receipts for September are \$97,200; cash disbursements are expected to be \$115,000. How much cash, if any, must Hull borrow to maintain the desired minimum monthly balance? Determine your answer by using the basic form of the cash budget.

Prepare a cash budget.

(LO 8), AP

Exercises

E7-1 Bank employees use a system known as the “maker-checker” system. An employee will record an entry in the appropriate journal, and then a supervisor will verify and approve the entry. These days, as all of a bank's accounts are computerized, the employee first enters a batch of entries into the computer, and then the entries are posted automatically to the general ledger account after the supervisor approves them on the system.

Identify the principles of internal control.

(LO 2), C

Access to the computer system is password-protected and task-specific, which means that the computer system will not allow the employee to approve a transaction or the supervisor to record a transaction.

Instructions

Identify the principles of internal control inherent in the “maker-checker” procedure used by banks.

E7-2 Rosa's Pizza operates strictly on a carryout basis. Customers pick up their orders at a counter where a clerk exchanges the pizza for cash. While at the counter, the customer can see other employees making the pizzas and the large ovens in which the pizzas are baked.

Identify the principles of internal control.

(LO 2), C 

Instructions

Identify the six principles of internal control and give an example of each principle that you might observe when picking up your pizza. (*Note:* It may not be possible to observe all the principles.)

E7-3 The following control procedures are used in Kelton Company for over-the-counter cash receipts.

List internal control weaknesses over cash receipts and suggest improvements.

(LO 2, 3), E

1. Each store manager is responsible for interviewing applicants for cashier jobs. They are hired if they seem honest and trustworthy.
2. All over-the-counter receipts are registered by three clerks who share a cash register with a single cash drawer.
3. To minimize the risk of robbery, cash in excess of \$100 is stored in an unlocked attaché case in the stock room until it is deposited in the bank.

4. At the end of each day the total receipts are counted by the cashier on duty and reconciled to the cash register total.
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- 5. The company accountant makes the bank deposit and then records the day's receipts.

Instructions

- (a) For each procedure, explain the weakness in internal control and identify the control principle that is violated.
- (b) For each weakness, suggest a change in the procedure that will result in good internal control.

E7-4 The following control procedures are used in Penny's Boutique Shoppe for cash disbursements.

List internal control weaknesses for cash disbursements and suggest improvements.

(LO 2, 4), E

- 1. Each week, 100 company checks are left in an unmarked envelope on a shelf behind the cash register.
- 2. The store manager personally approves all payments before she signs and issues checks.
- 3. The store purchases used goods for resale from people that bring items to the store. Since that can occur anytime that the store is open, all employees are authorized to purchase goods for resale by issuing cash from the register. The purchase is documented by having the store employee write on a piece of paper a description of the item that was purchased and the amount that was paid. The employee then signs the paper and puts it in the register.
- 4. After payment, bills are "filed" in a paid invoice folder.
- 5. The company accountant prepares the bank reconciliation and reports any discrepancies to the owner.

Instructions

- (a) For each procedure, explain the weakness in internal control and identify the internal control principle that is violated.
- (b) For each weakness, suggest a change in the procedure that will result in good internal control.

E7-5 At Nunez Company, checks are not prenumbered because both the purchasing agent and the treasurer are authorized to issue checks. Each signer has access to unissued checks kept in an unlocked file cabinet. The purchasing agent pays all bills pertaining to goods purchased for resale. Prior to payment, the purchasing agent determines that the goods have been received and verifies the mathematical accuracy of the vendor's invoice. After payment, the invoice is filed by vendor name and the purchasing agent records the payment in the cash disbursements journal. The treasurer pays all other bills following approval by authorized employees. After payment, the treasurer stamps all bills "paid," files them by payment date, and records the checks in the cash disbursements journal. Nunez Company maintains one checking account that is reconciled by the treasurer.

Identify internal control weaknesses for cash disbursements and suggest improvements.

(LO 2, 4), E

Instructions

- (a) List the weaknesses in internal control over cash disbursements.
- (b) Identify improvements for correcting these weaknesses.

E7-6 Sally Rice is unable to reconcile the bank balance at January 31. Sally's reconciliation is shown here.

Prepare bank reconciliation and adjusting entries.

(LO 5), AP

Cash balance per bank \$3,677.20

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Add: NSF check

450.00

Less: Bank service charge	<u>28.00</u>
Adjusted balance per bank	\$4,099.20
Cash balance per books	\$3,975.20
Less: Deposits in transit	590.00
Add: Outstanding checks	<u>770.00</u>
Adjusted balance per books	\$4,155.20

Instructions

- (a) What is the proper adjusted cash balance per bank?
- (b) What is the proper adjusted cash balance per books?
- (c) Prepare the adjusting journal entries necessary to determine the adjusted cash balance per books.

E7-7 At April 30, the bank reconciliation of Longacre Company shows three outstanding checks: No. 254 \$650, No. 255 \$700, and No. 257 \$410. The May bank statement and the May cash payments journal are given here.

Determine outstanding checks.

(LO 5), AP

Bank Statement

Checks Paid

<u>Date</u>	<u>Check No.</u>	<u>Amount</u>
5-4	254	\$650
5-2	257	410
5-17	258	159
5-12	259	275

Bank Statement

Checks Paid

<u>Date</u>	<u>Check No.</u>	<u>Amount</u>
5-20	260	925
5-29	263	480
5-30	262	750

Cash Payments Journal

Checks Issued

<u>Date</u>	<u>Check No.</u>	<u>Amount</u>
5-2	258	\$159
5-5	259	275
5-10	260	925
5-15	261	500
5-22	262	750
5-24	263	480
5-29	264	360

Instructions

Using step 2 in the reconciliation procedure (see [page 355](#)), list the outstanding checks at May 31.

E7-8 The following information pertains to Joyce Company.

Prepare bank reconciliation and adjusting entries.

(LO 5), AP

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- 1. Cash balance per bank, July 31, \$7,328.
- 2. July bank service charge not recorded by the depositor \$38.
- 3. Cash balance per books, July 31, \$7,364.
- 4. Deposits in transit, July 31, \$2,700.
- 5. Note for \$2,000 collected for Joyce Company in July by the bank, plus interest \$36 less fee \$20. The collection has not been recorded by Joyce Company, and no interest has been accrued.
- 6. Outstanding checks, July 31, \$686.

Instructions

- (a) Prepare a bank reconciliation at July 31, 2014.
- (b) Journalize the adjusting entries at July 31 on the books of Joyce Company.

E7-9 This information relates to the Cash account in the ledger of Treanor Company.

Prepare bank reconciliation and adjusting entries.

(LO 5), AP



- Balance September 1—\$16,400; Cash deposited—\$64,000 Balance September 30—\$17,600; Checks written—\$62,800

The September bank statement shows a balance of \$16,500 at September 30 and the following memoranda.

	Credits		Debits
Collection of \$1,800 note plus interest \$30	\$1,830	NSF check: H. Kane	\$560
Interest earned on checking account	45	Safety deposit box rent	60

At September 30, deposits in transit were \$4,738 and outstanding checks totaled \$2,383.

Instructions

- (a) Prepare the bank reconciliation at September 30, 2014.
- (b) Prepare the adjusting entries at September 30, assuming (1) the NSF check was from a customer on account, and (2) no interest had been accrued on the note.

E7-10 The cash records of Downs Company show the following.

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Compute deposits in transit and outstanding checks for two bank reconciliations.

(LO 5), AP

For July:

- 1. The June 30 bank reconciliation indicated that deposits in transit total \$580. During July, the general ledger account Cash shows deposits of \$16,900, but the bank statement indicates that only \$15,600 in deposits were received during the month.
- 2. The June 30 bank reconciliation also reported outstanding checks of \$940. During the month of July, Downs Company books show that \$17,500 of checks were issued, yet the bank statement showed that \$16,400 of checks cleared the bank in July.

For September:

- 3. In September, deposits per bank statement totaled \$25,900, deposits per books were \$26,400, and deposits in transit at September 30 were \$2,200.
- 4. In September, cash disbursements per books were \$23,500, checks clearing the bank were \$24,000, and outstanding checks at September 30 were \$2,100.

There were no bank debit or credit memoranda, and no errors were made by either the bank or Downs Company.

Instructions

Answer the following questions.

- (a) In situation 1, what were the deposits in transit at July 31?
- (b) In situation 2, what were the outstanding checks at July 31?
- (c) In situation 3, what were the deposits in transit at August 31?
- (d) In situation 4, what were the outstanding checks at August 31?

E7-11 Werth Inc.'s bank statement from Hometown Bank at August 31, 2014, gives the following information.

Prepare bank reconciliation and adjusting entries.

(LO 5), AP

Balance, August 1	\$18,400	Bank debit memorandum:	
August deposits	71,000	Safety deposit box fee	\$ 25
Checks cleared in August	68,678	Service charge	50
Bank credit memorandum:		Balance, August 31	20,692
Interest earned	45		

A summary of the Cash account in the ledger for August shows the following: balance, August 1, \$18,700; receipts \$74,000; disbursements \$73,570; and balance, August 31, \$19,130. Analysis reveals that the only reconciling items on

the July 31 bank reconciliation were a deposit in transit for \$4,800 and outstanding checks of \$4,500. In addition, you determine that there was an error involving a company check drawn in August: A check for \$400 to a creditor on account that cleared the bank in August was journalized and posted for \$40.

Instructions

- (a) Determine deposits in transit.
- (b) Determine outstanding checks. (*Hint: You need to correct disbursements for the check error.*)
- (c) Prepare a bank reconciliation at August 31.
- (d) Journalize the adjusting entry(ies) to be made by Werth Inc. at August 31.

E7-12 A new accountant at Leftwich Inc. is trying to identify which of the amounts shown below should be reported as the current asset “Cash and cash equivalents” in the year-end balance sheet, as of April 30, 2014.

Identify reporting of cash.

(LO 6), AP

- 1. \$60 of currency and coin in a locked box used for incidental cash transactions.
- 2. A \$10,000 U.S. Treasury bill, due May 31, 2014.
- 3. \$260 of April-dated checks that Leftwich has received from customers but not yet deposited.
- 4. An \$85 check received from a customer in payment of its April account, but postdated to May 1.
- 5. \$2,500 in the company’s checking account.
- 6. \$4,800 in its savings account.
- 7. \$75 of prepaid postage in its postage meter.
- 8. A \$25 IOU from the company receptionist.

Instructions

- (a) What balance should Leftwich report as its “Cash and cash equivalents” balance at April 30, 2014?
- (b) In what account(s) and in what financial statement(s) should the items not included in “Cash and cash equivalents” be reported?

E7-13 Canzer, Morel, and Wang, three law students who have joined together to open a law practice, are struggling to manage their cash flow. They haven’t yet built up sufficient clientele and revenues to support their legal practice’s ongoing costs. Initial costs, such as advertising, renovations to their premises, and the like, all result in outgoing cash flow at a time when little is coming in. Canzer, Morel, and Wang haven’t had time to establish a billing system since most of their clients’ cases haven’t yet reached the courts, and the lawyers didn’t think it would be right to bill them until “results were achieved.”

Review cash management practices.

(LO 7), C

Unfortunately, Canzer, Morel, and Wang’s suppliers don’t feel the same way. Their suppliers expect them to pay their accounts payable within a few days of receiving their bills. So far, there hasn’t even been enough money to pay the three lawyers, and they are not sure how long they can keep practicing law without getting some money into their pockets.

Instructions

Can you provide any suggestions for Canzer, Morel, and Wang to improve their cash management practices?

E7-14 Enright Company expects to have a cash balance of \$46,000 on January 1, 2014. These are the relevant monthly budget data for the first two months of 2014.

Prepare a cash budget for two months.



- 1. Collections from customers: January \$71,000, February \$146,000.
- 2. Payments to suppliers: January \$40,000, February \$75,000.
- 3. Wages: January \$30,000, February \$40,000. Wages are paid in the month they are incurred.
- 4. Administrative expenses: January \$21,000, February \$24,000. These costs include depreciation of \$1,000 per month. All other costs are paid as incurred.
- 5. Selling expenses: January \$15,000, February \$20,000. These costs are exclusive of depreciation. They are paid as incurred.
- 6. Sales of short-term investments in January are expected to realize \$12,000 in cash. Enright has a line of credit at a local bank that enables it to borrow up to \$25,000. The company wants to maintain a minimum monthly cash balance of \$20,000.

Instructions

Prepare a cash budget for January and February.

***E7-15** During October, Wichita Light Company experiences the following transactions in establishing a petty cash fund.

Prepare journal entries for a petty cash fund.

(LO 9), AP

Oct. 1 A petty cash fund is established with a check for \$150 issued to the petty cash custodian.

31 A check was written to reimburse the fund and increase the fund to \$200.

A count of the petty cash fund disclosed the following items:

Currency	\$59.00
----------	---------

Coins	0.70
-------	------

Expenditure receipts (vouchers):

Supplies	\$26.10
----------	---------

Telephone, Internet, and fax	16.40
------------------------------	-------

Freight-out

6.80

Instructions

Journalize the entries in October that pertain to the petty cash fund.

***E7-16** Lyle Company maintains a petty cash fund for small expenditures. These transactions occurred during the month of August.

Journalize and post petty cash fund transactions.

(LO 9), AP

- Aug.
1 Established the petty cash fund by writing a check on Westtown Bank for \$200.
- 15 Replenished the petty cash fund by writing a check for \$175. On this date, the fund consisted of \$25 in cash and these petty cash receipts: freight-out \$74.40, entertainment expense \$36, postage expense \$33.70, and miscellaneous expense \$27.50.
- 16 Increased the amount of the petty cash fund to \$400 by writing a check for \$200.
- 31 Replenished the petty cash fund by writing a check for \$283. On this date, the fund consisted of \$117 in cash and these petty cash receipts: postage expense \$145, entertainment expense \$90.60, and freight-out \$46.40.

Instructions

- (a) Journalize the petty cash transactions.
- (b) Post to the Petty Cash account.
- (c) What internal control features exist in a petty cash fund?

Exercises: Set B and Challenge Exercises

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Exercise Set B and Challenge Exercises.

Problems: Set A

P7-1A Granada Theater is in the Greenbelt Mall. A cashier's booth is located near the entrance to the theater. Two cashiers are employed. One works from 1:00 to 5:00 p.m., the other from 5:00 to 9:00 p.m. Each cashier is bonded. The cashiers receive cash from customers and operate a machine that ejects serially numbered tickets. The rolls of tickets are inserted and locked into the machine by the theater manager at the beginning of each cashier's shift.

Identify internal control weaknesses for cash receipts.

(LO 2, 3), C 

After purchasing a ticket, the customer takes the ticket to a doorperson stationed at the entrance of the theater lobby some 60 feet from the cashier's booth. The doorperson tears the ticket in half, admits the customer, and returns the ticket stub to the customer. The other half of the ticket is dropped into a locked box by the doorperson.

At the end of each cashier's shift, the theater manager removes the ticket rolls from the machine and makes a cash count. The cash count sheet is initialed by the cashier. At the end of the day, the manager deposits the receipts in total in a bank night deposit vault located in the mall. In addition, the manager sends copies of the deposit slip and the initialed cash count sheets to the theater company treasurer for verification and to the company's accounting department. Receipts from the first shift are stored in a safe located in the manager's office.

Instructions

- (a) Identify the internal control principles and their application to the cash receipts transactions of Granada Theater.
- (b) If the doorperson and cashier decided to collaborate to misappropriate cash, what actions might they take?

P7-2A Flint Hills Middle School wants to raise money for a new sound system for its auditorium. The primary fund-raising event is a dance at which the famous disc jockey Jay Dee will play classic and not-so-classic dance tunes. Trent Greeley, the music and theater instructor, has been given the responsibility for coordinating the fund-raising efforts. This is Trent's first experience with fund-raising. He decides to put the eighth-grade choir in charge of the event; he will be a relatively passive observer.

Identify internal control weaknesses in cash receipts and cash disbursements.

(LO 2, 3, 4), C

Trent had 500 unnumbered tickets printed for the dance. He left the tickets in a box on his desk and told the choir students to take as many tickets as they thought they could sell for \$5 each. In order to ensure that no extra tickets would be floating around, he told them to dispose of any unsold tickets. When the students received payment for the tickets, they were to bring the cash back to Trent, and he would put it in a locked box in his desk drawer.

Some of the students were responsible for decorating the gymnasium for the dance. Trent gave each of them a key to the money box and told them that if they took money out to purchase materials, they should put a note in the box saying how much they took and what it was used for. After two weeks, the money box appeared to be getting full, so Trent asked Sandy Overbay to count the money, prepare a deposit slip, and deposit the money in a bank account Trent had opened.

The day of the dance, Trent wrote a check from the account to pay Jay Dee. The DJ said, however, that he accepted only cash and did not give receipts. So Trent took \$200 out of the cash box and gave it to Jay. At the dance, Trent had Deb Younger working at the entrance to the gymnasium, collecting tickets from students and selling tickets to those who had not pre-purchased them. Trent estimated that 400 students attended the dance.

The following day, Trent closed out the bank account, which had \$250 in it, and gave that amount plus the \$180 in the cash box to Principal Ramirez. Principal Ramirez seemed surprised that, after generating roughly \$2,000 in sales, the dance netted only \$430 in cash. Trent did not know how to respond.

Instructions

Identify as many internal control weaknesses as you can in this scenario, and suggest how each could be addressed.

P7-3A On July 31, 2014, Redeker Company had a cash balance per books of \$6,140. The statement from Nashota State Bank on that date showed a balance of \$7,690.80. A comparison of the bank statement with the Cash account revealed the following facts.

Prepare a bank reconciliation and adjusting entries.

(LO 5), AP

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- 1. The bank service charge for July was \$25.
- 2. The bank collected a note receivable of \$1,500 for Redeker Company on July 15, plus \$30 of interest. The bank made a \$10 charge for the collection. Redeker has not accrued any interest on the note.
- 3. The July 31 receipts of \$1,193.30 were not included in the bank deposits for July. These receipts were deposited by the company in a night deposit vault on July 31.
- 4. Company check No. 2480 issued to T. Laird, a creditor, for \$384 that cleared the bank in July was incorrectly entered in the cash payments journal on July 10 for \$348.
- 5. Checks outstanding on July 31 totaled \$1,860.10.
- 6. On July 31, the bank statement showed an NSF charge of \$575 for a check received by the company from K. Wagner, a customer, on account.

Instructions

- (a) Prepare the bank reconciliation as of July 31.
 - (a) Adjusted cash bal. \$7,024.00
- (b) Prepare the necessary adjusting entries at July 31.

P7-4A The bank portion of the bank reconciliation for LaRoche Company at October 31, 2014, is shown below.

Prepare a bank reconciliation and adjusting entries from detailed data.

(LO 5), AP

LAROCHE COMPANY
Bank Reconciliation
October 31, 2014

Cash balance per bank	\$12,367.90
Add: Deposits in transit	<u>1,530.20</u>
	13,898.10

Less: Outstanding checks

<u>Check Number</u>	<u>Check Amount</u>
2451	\$1,260.40
2470	684.20
2471	844.50

LAROCHE COMPANY

Bank Reconciliation

October 31, 2014

2472	426.80	
2474	<u>1,050.00</u>	<u>4,265.90</u>
Adjusted cash balance per bank		\$9,632.20

The adjusted cash balance per bank agreed with the cash balance per books at October 31. The November bank statement showed the following checks and deposits.

Bank Statement

Checks

Deposits

<u>Date</u>	<u>Number</u>	<u>Amount</u>	<u>Date</u>	<u>Amount</u>
11-1	2470	\$ 684.20	11-1	\$1,530.20
11-2	2471	844.50	11-4	1,211.60
11-5	2474	1,050.00	11-8	990.10
11-4	2475	1,640.70	11-13	2,575.00
11-8	2476	2,830.00	11-18	1,472.70
11-10	2477	600.00	11-21	2,945.00
11-15	2479	1,750.00	11-25	2,567.30
11-18	2480	1,330.00	11-28	1,650.00

Bank Statement

Checks			Deposits	
<u>Date</u>	<u>Number</u>	<u>Amount</u>	<u>Date</u>	<u>Amount</u>
11-27	2481	695.40	11-30	<u>1,186.00</u>
11-30	2483	575.50	Total	\$16,127.90
11-29	2486	<u>940.00</u>		
	Total	\$12,940.30		

The cash records per books for November showed the following.

Cash Payments Journal

<u>Date</u>	<u>Number</u>	<u>Amount</u>
11-1	2475	\$1,640.70
11-2	2476	2,830.00
11-2	2477	600.00
11-4	2478	538.20
11-8	2479	1,705.00
11-10	2480	1,330.00
11-15	2481	695.40

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Cash Payments Journal

<u>Date</u>	<u>Number</u>	<u>Amount</u>
11-18	2482	612.00
11-20	2483	\$ 575.50
11-22	2484	829.50
11-23	2485	974.80
11-24	2486	940.00
11-29	2487	398.00
11-30	2488	<u>800.00</u>
Total		\$14,469.10

Cash Receipts Journal

<u>Date</u>	<u>Amount</u>
11-3	\$1,211.60
11-7	990.10
11-12	2,575.00
11-17	1,472.70
11-20	2,954.00

Cash Receipts Journal

<u>Date</u>	<u>Amount</u>
11-24	2,567.30
11-27	1,650.00
11-29	1,186.00
11-30	<u>1,304.00</u>
Total	\$15,910.70

The bank statement contained two bank memoranda:

- 1. A credit of \$2,242 for the collection of a \$2,100 note for LaRoche Company plus interest of \$157 and less a collection fee of \$15. LaRoche Company has not accrued any interest on the note.
- 2. A debit for the printing of additional company checks \$85.

At November 30, the cash balance per books was \$11,073.80 and the cash balance per bank statement was \$17,712.50. The bank did not make any errors, but **LaRoche Company made two errors.**

Instructions

- (a) Using the four steps in the reconciliation procedure described on [page 355](#), prepare a bank reconciliation at November 30, 2014.

(a) Adjusted cash bal. \$13,176.80

- (b) Prepare the adjusting entries based on the reconciliation. (*Note:* The correction of any errors pertaining to recording checks should be made to Accounts Payable. The correction of any errors relating to recording cash receipts should be made to Accounts Receivable.)

P7-5A Zimmerman Company of Shawnee, Kansas, spreads herbicides and applies liquid fertilizer for local farmers. On May 31, 2014, the company's Cash account per its general ledger showed a balance of \$6,738.90.

Prepare a bank reconciliation and adjusting entries.

(LO 5), AP

The bank statement from Shawnee State Bank on that date showed the following balance.

SHAWNEE STATE BANK

- 1. Gross profit is 25% of sales.
- 2. Actual and budgeted sales data:

March (actual) \$46,000

April (budgeted) 70,000

- 3. Sales are both cash and credit. Cash collections expected in April are:

March \$18,400 (40% of \$46,000)

April 42,000 (60% of \$70,000)

\$60,400

- 4. Half of a month's purchases are paid for in the month of purchase and half in the following month. Cash disbursements expected in April are:

Purchases March \$22,400

Purchases April 28,100

\$50,500

- 5. Cash operating costs are anticipated to be \$11,200 for the month of April.
- 6. Equipment costing \$2,500 will be purchased for cash in April.
- 7. The company wishes to maintain a minimum cash balance of \$9,000. An open line of credit is available at the bank. All borrowing is done at the beginning of the month, and all repayments are made at the end of the month. The interest rate is 12% per year, and interest expense is accrued at the end of the month and paid in the following month.

Instructions

Prepare a cash budget for the month of April. Determine how much cash Langerhan Inc. must borrow, or can repay, in April.

Apr. borrowings \$1,800

P7-7A Castle Corporation prepares monthly cash budgets. Here are relevant data from operating budgets for 2014.

Prepare a cash budget.

(LO 8), AP



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	<u>January</u>	<u>February</u>
Sales	\$360,000	\$400,000
Purchases	120,000	130,000
Salaries	84,000	81,000
Administrative expenses	72,000	75,000
Selling expenses	79,000	88,000

All sales and purchases are on account. Budgeted collections and disbursement data are given below. All other expenses are paid in the month incurred except for administrative expenses, which include \$1,000 of depreciation per month.

Other data.

- 1. Collections from customers: January \$326,000; February \$378,000.
- 2. Payments for purchases: January \$110,000; February \$135,000.
- 3. Other receipts: January: collection of December 31, 2013, notes receivable \$15,000; February: proceeds from sale of securities \$4,000.
- 4. Other disbursements: February \$10,000 cash dividend.

The company's cash balance on January 1, 2014, is expected to be \$46,000. The company wants to maintain a minimum cash balance of \$40,000.

Instructions

Prepare a cash budget for January and February.

Jan. 31 adjusted cash bal. \$43,000

P7-8A Heisey Company is a very profitable small business. It has not, however, given much consideration to internal control. For example, in an attempt to keep clerical and office expenses to a minimum, the company has combined the jobs of cashier and bookkeeper. As a result, Terry Baden handles all cash receipts, keeps the accounting records, and prepares the monthly bank reconciliations.

Prepare a comprehensive bank reconciliation with theft and internal control deficiencies.

(LO 2, 3, 4, 5), E

The balance per the bank statement on October 31, 2014, was \$18,380. Outstanding checks were: No. 62 for \$140.75, No. 183 for \$180, No. 284 for \$253.25, No. 862 for \$190.71, No. 863 for \$226.80, and No. 864 for \$165.28. Included with the statement was a credit memorandum of \$185 indicating the collection of a note receivable for Heisey Company by the bank on October 25. This memorandum has not been recorded by Heisey.

The company's ledger showed one Cash account with a balance of \$21,877.72. The balance included undeposited cash on hand. Because of the lack of internal controls, Terry took for personal use all of the undeposited receipts in excess of \$3,795.51. He then prepared the following bank reconciliation in an effort to conceal his theft of cash.

Cash balance per books, October 31		\$21,877.72
Add: Outstanding checks		
No. 862	\$190.71	
No. 863	226.80	
No. 864	<u>165.28</u>	<u>482.79</u>
		22,360.51
Less: Undeposited receipts		<u>3,795.51</u>
Unadjusted balance per bank, October 31		18,565.00
Less: Bank credit memorandum		<u>185.00</u>
Cash balance per bank statement, October 31		\$18,380.00

Instructions

- (a) Prepare a correct bank reconciliation. (*Hint:* Deduct the amount of the theft from the adjusted balance per books.)
 - (a) Adjusted cash bal. \$21,018.72
- (b) Indicate the three ways that Terry attempted to conceal the theft and the dollar amount involved in each method.
- (c) What principles of internal control were violated in this case?

Problems: Set B

P7-1B The Soccer Club decided to sell coupon books as a fund-raising activity. The books allow users to enjoy restaurants, entertainment, and services such as oil changes, at substantial discounts. The club bought 100 books for \$16 each, and members will sell them for \$20. About 20 members attended the last club meeting, and most took one or two books to sell. Since the club had already paid for the books and didn't have other immediate cash needs, members do not have to pay for the books until they sell them.

Identify internal control weaknesses for cash receipts.

Extra books are stored on a book shelf in the club's on-campus office. The office is in a great location with plenty of student traffic. It is shared with the Marketing and Information Systems clubs. Each club has four sets of keys that are used by its officers and members.

As students sell books, they bring the cash or checks to the club's office. Students with unusual class schedules who arrive when the office is locked can put payments under the door. Payments are stored in a desk drawer until the treasurer has time to make a bank deposit. Students can pick up more books to sell as needed.

Instructions

- (a) Indicate the weaknesses in internal accounting control in the club's fund-raising plan.
- (b) Indicate improvements in internal control procedures for the club's fund-raising plan.

P7-2B Tom Hall has worked for Dr. Johnson for several years. Tom demonstrates a loyalty that is rare among employees. He is always willing to "cover" for other employees and hasn't taken a vacation in three years.

Identify internal control weaknesses in cash receipts and cash disbursements.

(LO 2, 3, 4), C

One of Tom's primary duties at the dental office is to open the mail, list checks received, and prepare the bank deposit form.

He also collects cash from patients at the cashier window as patients leave. At times, it is so hectic that Tom doesn't bother to give patients a receipt for the cash paid on their accounts. He assures them he will see to it that they receive the proper credit. He is so well known by most patients that no one has ever complained.

When traffic is slow in the office, Tom offers to help another employee, Sue, post the payments to patients' accounts receivable. Dr. Johnson installed a computerized accounting program that requires a user ID and password to log in, but Tom and Sue have found that it is more efficient to just leave the computer on and the receivables file open all the time, and minimize the file when it is not in use.

Instructions

Identify the principles of internal control that may be violated in this situation.

P7-3B On March 31, 2014, Taggart Company had a cash balance per books of \$5,174.20. The statement from Western Bank on that date showed a balance of \$6,041.40. A comparison of the bank statement with the cash account revealed the following facts.

Prepare a bank reconciliation and adjusting entries.

(LO 5), AP

- 1. The bank service charge for March was \$28.
- 2. The bank collected a note receivable of \$2,000 for Taggart Company on March 15, plus \$115 of interest. The bank made a \$20 charge for the collection. Taggart has not accrued any interest on the note.
- 3. The March 31 receipts of \$1,481.60 were not included in the bank deposits for March. These receipts were deposited by the company in a night deposit vault on March 31.
- 4. Company check No. 1245 issued to T. Gilroy, a creditor, for \$672 that cleared the bank in March was incorrectly entered in the cash payments journal on March 8 for \$627.
- 5. Checks outstanding on March 31 totaled \$1,360.00.
- 6. On March 31 the bank statement showed an NSF charge of \$1,033.20 for a check received by the company from R. Fross, a customer, on account.

Instructions

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- (a) Prepare the bank reconciliation as of March 31.

(a) Adjusted cash bal. \$6,163
- (b) Prepare the necessary adjusting entries at March 31.

P7-4B The bank portion of the bank reconciliation for Triad Imports, Inc. at July 31, 2014, is shown below.

Prepare a bank reconciliation and adjusting entries from detailed data. (LO 5), AP

TRIAD IMPORTS, INC.

Bank Reconciliation

July 31, 2014

Cash balance per bank	\$9,596
Add: Deposits in transit	<u>930</u>
	\$10,526

Less: Outstanding checks

<u>Check Number</u>	<u>Check Amount</u>	
3151	\$290	
3170	812	
3171	1,538	
3172	1,000	
3174	<u>1,172</u>	<u>4,812</u>
Adjusted cash balance per bank		\$5,714

The adjusted cash balance per bank agreed with the cash balance per books at July 31. The August bank statement showed the following checks and deposits.

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Bank Statement

Checks			Deposits	
<u>Date</u>	<u>Number</u>	<u>Amount</u>	<u>Date</u>	<u>Amount</u>
8-1	3170	\$ 812	8-1	\$930
8-2	3171	1,538	8-4	1,325
8-5	3174	1,172	8-8	1,152
8-4	3175	802	8-13	1,104
8-8	3176	132	8-18	1,587
8-10	3177	737	8-21	1,159
8-15	3179	1,325	8-25	1,054
8-18	3180	900	8-28	1,830
8-27	3181	596	8-30	<u>1,067</u>
8-30	3183	93	Total	\$11,208
8-29	3187	<u>734</u>		
	Total	\$8,841		

The cash records per books for August showed the following.

Cash Payments Journal

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<u>Date</u>	<u>Cash Payments Journal</u>	<u>Amount</u>
8-1	3175	\$ 802
8-2	3176	132
<u>Date</u>	<u>Number</u>	<u>Amount</u>
8-2	3177	737
8-4	3178	1,598
8-8	3179	1,325
8-10	3180	900
8-15	3181	569
8-18	3182	\$1,508
8-20	3183	\$93
8-22	3184	760
8-23	3185	1,038
8-24	3186	455
8-29	3187	734
8-30	3188	<u>273</u>
Total		\$10,924

Cash Receipts Journal

Cash Receipts Journal

8-3	\$ 1,325
8-7	1,152
8-12	1,014
8-17	1,587
8-20	1,159
8-24	1,054
8-27	1,830
8-29	1,067
8-30	<u>500</u>
Total	\$10,668

The bank statement contained two bank memoranda:

- 1. A credit of \$1,670 for the collection of a \$1,600 note for Triad Imports plus interest of \$80 and less a collection fee of \$10. Triad Imports has not accrued any interest on the note.
- 2. A debit for the printing of additional company checks \$70.

At August 31, the cash balance per books was \$5,478, and the cash balance per bank statement was \$13,563. The bank did not make any errors, but **Triad Imports, Inc. made two errors.**

Instructions

- (a) Using the four steps in the reconciliation procedure described in the textbook, prepare a bank reconciliation at August 31, 2014.

(a) Adjusted cash bal. \$7,141

- (b) Prepare the adjusting entries based on the reconciliation. (*Note:* The correction of any errors pertaining to recording checks should be made to Accounts Payable. The correction of any errors relating to recording cash receipts should be made to Accounts Receivable.)

P7-5B Bug Busters Company performs insect extermination services. On October 31, 2014, the company's cash account per its general ledger showed a balance of \$4,632. **PRINTED BY: jromero0950@email.phoenix.edu. Printing is for personal, private use only. No part of this book may be reproduced or transmitted without publisher's prior permission. Violators will be prosecuted.**

The bank statement from Central Bank on that date showed the following balance.

Prepare a bank reconciliation and adjusting entries.

(LO 5), AP

The bank statement from Central Bank on that date showed the following balance.

CENTRAL BANK

<u>Checks and Debits</u>	<u>Deposits and Credits</u>	<u>Daily Balance</u>
XXX	XXX	10-31 4,070

A comparison of the details on the bank statement with the details in the cash account revealed the following facts.

- 1. The statement included a debit memo of \$50 for the printing of additional company checks.
- 2. Cash sales of \$342 on October 6 were deposited in the bank. The cash receipts journal entry and the deposit slip were incorrectly made for \$372. The bank credited Bug Busters Company for the correct amount.
- 3. Outstanding checks at October 31 totaled \$1,250, and deposits in transit were \$2,390.
- 4. On October 13, the company issued check No. 4263 for \$196 to T. Grey, on account. The check, which cleared the bank in May, was incorrectly journalized and posted by Bug Busters Company for \$169.
- 5. A \$1,000 note receivable was collected by the bank for Bug Busters Company on October 31 plus \$50 interest. The bank charged a collection fee of \$15. No interest has been accrued on the note.
- 6. Included with the canceled checks was a check issued by Fig Leaf Company for \$120 that was incorrectly charged to Bug Busters Company by the bank.
- 7. On October 31, the bank statement showed an NSF charge of \$230 for a check issued by Jon Simpson, a customer, to Bug Busters Company on account.

Instructions

- (a) Prepare the bank reconciliation at October 31, 2014.
 - (a) Adjusted cash bal. \$5,330
- (b) Prepare the necessary adjusting entries for Bug Busters Company at October 31, 2014.

P7-6B You are provided with the following information taken from Items Inc.'s May 31, 2014, balance sheet.

Prepare a cash budget.

(LO 8), AP 

Cash	\$ 19,000
Accounts receivable	47,600

Property, plant, and equipment, net of depreciation	70,400
Accounts payable	18,200
Common stock	110,000
Retained earnings	21,800

Additional information concerning Items Inc. is as follows.

- 1. Gross profit is 40% of sales.
- 2. Actual and budgeted sales data:

May (actual)	\$68,000
--------------	----------

June (budgeted)	60,000
-----------------	--------

- 3. Sales are both cash and credit. Cash collections expected in June are:

May	\$47,600	(70% of \$68,000)
-----	----------	-------------------

June	<u>18,000</u>	(30% of \$60,000)
------	---------------	-------------------

\$65,600

- 4. Half of a month's purchases are paid for in the month of purchase and half in the following month. Cash disbursements expected in June are:

Purchases May	\$18,200
---------------	----------

Purchases June	<u>27,500</u>
----------------	---------------

\$45,700

- 5. Cash operating costs are anticipated to be \$21,300 for the month of June.
- 6. Equipment costing \$6,000 will be purchased for cash in June.
- 7. The company wishes to maintain a minimum cash balance of \$11,000. An open line of credit is available at the bank. All borrowing is done at the beginning of the month, and all repayments are made at the end of the month. The interest rate is 9% per year, and interest expense is accrued at the end of the month and paid in the following month.

Instructions

Prepare a cash budget for the month of June. Determine how much cash Items Inc. must borrow, or can repay, in June.

Prepare a cash budget.

(LO 8), AP 

	<u>January</u>	<u>February</u>
Sales	\$260,000	\$318,000
Purchases	112,000	120,000
Salaries	72,000	78,000
Administrative expenses	58,000	60,000
Selling expenses	30,000	36,000

All sales and purchases are on account. Budgeted collections and disbursement data are given below. All other expenses are paid in the month incurred except for administrative expenses, which include \$2,000 of depreciation per month.

Other data:

- 1. Collections from customers: January \$279,500; February \$298,000.
- 2. Payment for purchases: January \$106,000; February \$116,000.
- 3. Other receipts—January: collection of December 31, 2013, interest receivable \$7,500; February: proceeds from sale of securities \$8,000
- 4. Other disbursements—January: pay \$35,000 note payable due January 1, 2014; February: pay \$5,000 cash dividend
- 5. The company's cash balance on January 1, 2014 is expected to be \$52,000. The company wants to maintain a minimum cash balance of \$40,000.

Instructions

Prepare a cash budget for January and February.

Jan. 31 adjusted cash bal. \$40,000

P7-8B Elite Service Company is a very profitable small business. It has not, however, given much consideration to internal control. For example, in an attempt to keep clerical and office expenses to a minimum, the company has combined the jobs of cashier and bookkeeper. As a result, Steve Evans handles all cash receipts, keeps the accounting records, and prepares the monthly bank reconciliations.

Prepare a comprehensive bank reconciliation with theft and internal control deficiencies.

PRINTED BY: jromero0950@email.phoenix.edu. Printing is for personal, private use only. No part of this book may be reproduced or transmitted without publisher's prior permission. Violators will be prosecuted. The balance per the bank statement on March 31, 2014, was \$5,931.51. Outstanding checks were: No. 206 for \$358.53, No. 441 for \$292, No. 590 for \$283.00, No. 781 for \$286.00, No. 782 for \$319.47, and No. 783 for \$303.14. Included with the statement was a credit memorandum of \$175 indicating the collection of a note receivable for Elite Service Company by the bank on March 21. This memorandum has not been recorded by Elite Service.

The company's ledger showed one cash account with a balance of \$6,889.53. The balance included undeposited cash on hand. Because of the lack of internal controls, Steve took for personal use all of the undeposited receipts in excess of \$1,591.63. He then prepared the following bank reconciliation in an effort to conceal his theft of cash.

Cash balance per books, March 31		\$6,889.53
Add: Outstanding checks		
No. 781	\$286.00	
No. 782	319.47	
No. 783	<u>303.14</u>	<u>808.61</u>
		7,698.14
Less: Undeposited receipts		<u>1,591.63</u>
Unadjusted balance per bank, March 31		6,106.51
Less: Bank credit memorandum		<u>175.00</u>
Cash balance per bank statement, March 31		\$5,931.51

Instructions

- (a) Prepare a correct bank reconciliation. (*Hint:* Deduct the amount of the theft from the adjusted balance per books.)
 - (a) Adjusted cash bal. \$5,681.00
- (b) Indicate the three ways that Steve attempted to conceal the theft and the dollar amount involved in each method.
- (c) What principles of internal control were violated in this case?

Problems: Set C

Comprehensive Problem

CP7 On December 1, 2014, Havenhill Company had the following account balances.

	<u>Debit</u>		<u>Credit</u>
Cash	\$18,200	Accumulated Depreciation—Equipment	
Notes Receivable	2,000	Equipment	\$ 3,000
Accounts Receivable	7,500	Accounts Payable	6,100
Inventory	16,000	Common Stock	50,000
Prepaid Insurance	1,600	Retained Earnings	<u>14,200</u>
Equipment	<u>28,000</u>		\$73,300
	\$73,300		

During December, the company completed the following transactions.

Dec. 7 Received \$3,600 cash from customers in payment of account (no discount allowed).

12 Purchased merchandise on account from Brown Co. \$12,000, terms 1/10, n/30.

17 Sold merchandise on account \$16,000, terms 2/10, n/30. The cost of the merchandise sold was \$10,000.

19 Paid salaries \$2,200.

22 Paid Brown Co. in full, less discount.

26 Received collections in full, less discounts, from customers billed on December 17.

31 Received \$2,700 cash from customers in payment of account (no discount allowed).

Adjustment data:

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- 1. Depreciation \$200 per month.
- 2. Insurance expired \$400.
- 3. Income tax expense was \$425. It was unpaid at December 31.

Instructions

- (a) Journalize the December transactions. (Assume a perpetual inventory system.)
- (b) Enter the December 1 balances in the ledger T-accounts and post the December transactions. Use Cost of Goods Sold, Depreciation Expense, Insurance Expense, Salaries and Wages Expense, Sales Revenue, Sales Discounts, Income Taxes Payable, and Income Tax Expense.
- (c) The statement from Jackson County Bank on December 31 showed a balance of \$25,930. A comparison of the bank statement with the Cash account revealed the following facts.
 - 1. The bank collected a note receivable of \$2,000 for Havenhill Company on December 15.
 - 2. The December 31 receipts were deposited in a night deposit vault on December 31. These deposits were recorded by the bank in January.
 - 3. Checks outstanding on December 31 totaled \$1,210.
 - 4. On December 31, the bank statement showed a NSF charge of \$680 for a check received by the company from L. Menke, a customer, on account.

Prepare a bank reconciliation as of December 31 based on the available information. (*Hint:* The cash balance per books is \$26,100. This can be proven by finding the balance in the Cash account from parts (a) and (b).)

- (d) Journalize the adjusting entries resulting from the bank reconciliation and adjustment data.
- (e) Post the adjusting entries to the ledger T-accounts.
- (f) Prepare an adjusted trial balance.

(f) Totals \$89,500

- (g) Prepare an income statement for December and a classified balance sheet at December 31.

(g) Net income \$ 2,455

Total assets \$ 73,180

Continuing Cookie Chronicle



(Note: This is a continuation of the Cookie Chronicle from [Chapters 1](#) through [6](#).)

CCC7 Part 1 Natalie is struggling to keep up with the recording of her accounting transactions. She is spending a lot of time marketing and selling mixers and giving her cookie classes. Her friend John is an accounting student who runs his own accounting service. He has asked Natalie if she would like to have him do her accounting. John and Natalie meet and discuss her business.

Part 2 Natalie decides that she cannot afford to hire John to do her accounting. One way that she can ensure that her Cash account does not have any errors and is accurate and up-to-date is to prepare a bank reconciliation at the end of each month. Natalie would like you to help her.

Go to the book's companion website, at www.wiley.com/college/kimmel, to see the completion of this problem.

Broadening Your Perspective

Financial Reporting and Analysis

FINANCIAL REPORTING PROBLEM: *Tootsie Roll Industries, Inc.*

BYP7-1 The financial statements of **Tootsie Roll** are presented in [Appendix A](#) of this book, together with an auditor's report—Report of Independent Auditors.



Instructions

PRINTED BY: jromero0950@email.phoenix.edu. Printing is for personal, private use only. No part of this book may be reproduced or transmitted without publisher's prior permission. Violators will be prosecuted. Using the financial statements and reports, answer these questions about Tootsie Roll's internal controls and cash.

- (a) What comments, if any, are made about cash in the "Report of Independent Registered Public Accounting Firm"?
- (b) What data about cash and cash equivalents are shown in the consolidated balance sheet (statement of financial position)?
- (c) What activities are identified in the consolidated statement of cash flows as being responsible for the changes in cash during 2011?
- (d) How are cash equivalents defined in the Notes to Consolidated Financial Statements?
- (e) Read the section of the report titled "Management's Report on Internal Control Over Financial Reporting." Summarize the statements made in that section of the report.

COMPARATIVE ANALYSIS PROBLEM: *Tootsie Roll vs. Hershey*



BYP7-2 The financial statements of **The Hershey Company** are presented in [Appendix B](#), following the financial statements for **Tootsie Roll** in [Appendix A](#).

Instructions

Answer the following questions for each company.

- (a) What is the balance in cash and cash equivalents at December 31, 2011?
- (b) What percentage of total assets does cash represent for each company over the last two years? Has it changed significantly for either company?
- (c) How much cash was provided by operating activities during 2011?
- (d) Comment on your findings in parts (a) through (c).

RESEARCH CASE

BYP7-3 The website www.cpa2biz.com has an article dated February 4, 2010, by Mary Schaeffer entitled "Emerging Issues: Demise of Paper Checks."

Instructions

Go to the website and do a search on the article title. Read the article and answer the following questions.

- (a) How many different forms of payment types does the article list? What are the payment types?
- (b) What problems does the shift away from paper checks to alternative payment options present for companies?
- (c) What five controls does the article suggest incorporating, to decrease problems associated with multiple payment options?

INTERPRETING FINANCIAL STATEMENTS

BYP7-4 The international accounting firm **Ernst & Young** performed a global survey on fraud. The results of that survey are summarized in a report titled "Driving Ethical Growth—New Markets, New Challenges" (Ernst & Young, *11th Global Fraud Survey*). You can find this report by doing an Internet search on the title, or go to

Instructions

Read the Executive Summary section, and then skim the remainder of the report to answer the following questions.

- (a) What was the global percentage of companies that experienced fraud during the period covered by the survey, and what region of the world had the highest rate?
- (b) What percentage of survey respondents performed a fraud risk assessment in the six months prior to the survey? What percentage of survey respondents have never performed a fraud risk assessment?
- (c) What percentage of respondents thought members of the board of directors were either “very concerned” or “fairly concerned” about board members’ personal legal liability resulting from fraud at their companies?
- (d) What are the top three issues of concern to compliance officers according to the survey?

REAL-WORLD FOCUS

BYP7-5 The **Financial Accounting Standards Board (FASB)** is a private organization established to improve accounting standards and financial reporting. The FASB conducts extensive research before issuing a “Statement of Financial Accounting Standards,” which represents an authoritative expression of generally accepted accounting principles.

Address: www.fasb.org, or go to www.wiley.com/college/kimmel

Steps

Choose **About FASB**.

Instructions

Answer the following questions.

- (a) What is the mission of the FASB?
- (b) How are topics added to the FASB technical agenda? (*Hint:* See Project Plans in Our Rules of Procedure.)
- (c) What characteristics make the FASB’s procedures an “open” decision-making process? (*Hint:* See Due Process in Our Rules of Procedure.)

BYP7-6 The **Public Company Accounting Oversight Board (PCAOB)** was created as a result of the Sarbanes-Oxley Act. It has oversight and enforcement responsibilities over accounting firms in the United States.

Address: <http://www.pcaobus.org/>, or go to www.wiley.com/college/kimmel

Instructions

Answer the following questions.

- (a) What is the mission of the PCAOB?
- (b) Briefly summarize its responsibilities related to inspections.
- (c) Briefly summarize its responsibilities related to enforcement.

Critical Thinking

DECISION-MAKING ACROSS THE ORGANIZATION

During a recent audit, Alternative Distributor Corp. was advised that existing internal controls necessary for the company to develop reliable financial statements were inadequate. The audit report stated that the current system of accounting for sales, receivables, and cash receipts constituted a material weakness. Among other items, the report focused on nontimely deposit of cash receipts, exposing Alternative Distributor to potential loss or misappropriation, excessive past due accounts receivable due to lack of collection efforts, disregard of advantages offered by vendors for prompt payment of invoices, absence of appropriate segregation of duties by personnel consistent with appropriate control objectives, inadequate procedures for applying accounting principles, lack of qualified management personnel, lack of supervision by an outside board of directors, and overall poor record-keeping.

Instructions

- (a) Identify the principles of internal control violated by Alternative Distributor Corporation.
- (b) Explain why managers of various functional areas in the company should be concerned about internal controls.

COMMUNICATION ACTIVITY

BYP7-8 As a new auditor for the CPA firm of Good and Rich, you have been assigned to review the internal controls over mail cash receipts of Lyman Company. Your review reveals that checks are promptly endorsed “For Deposit Only,” but no list of the checks is prepared by the person opening the mail. The mail is opened either by the cashier or by the employee who maintains the accounts receivable records. Mail receipts are deposited in the bank weekly by the cashier.

Instructions

Write a letter to D. A. Flynn, owner of the Lyman Company, explaining the weaknesses in internal control and your recommendations for improving the system.

ETHICS CASES

BYP7-9 Banks charge fees for “bounced” checks—that is, checks that exceed the balance in the account. It has been estimated that processing bounced checks costs a bank roughly \$1.50 per check. Thus, the profit margin on bounced checks is very high. Recognizing this, some banks have started to process checks from largest to smallest. By doing this, they maximize the number of checks that bounce if a customer overdraws an account. For example, NationsBank (now Bank of America) projected a \$14 million increase in fee revenue as a result of processing largest checks first. In response to criticism, banks have responded that their customers prefer to have large checks processed first, because those tend to be the most important. At the other extreme, some banks will cover their customers’ bounced checks, effectively extending them an interest-free loan while their account is overdrawn.

Instructions

Answer each of the following questions.

- (a) Richard Coulsen had a balance of \$1,500 in his checking account at First National Bank on a day when the bank received the following five checks for processing against his account.

<u>Check Number</u>	<u>Amount</u>	<u>Check Number</u>	<u>Amount</u>
3150	\$ 35	3165	\$ 550

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<u>Check Number</u>	<u>Amount</u>	<u>Check Number</u>	<u>Amount</u>
3162	400	3166	1,510
		3169	180

Assuming a \$30 fee assessed by the bank for each bounced check, how much fee revenue would the bank generate if it processed checks (1) from largest to smallest, (2) from smallest to largest, and (3) in order of check number?

- (b) Do you think that processing checks from largest to smallest is an ethical business practice?
- (c) In addition to ethical issues, what other issues must a bank consider in deciding whether to process checks from largest to smallest?
- (d) If you were managing a bank, what policy would you adopt on bounced checks?

BYP7-10 The National Fraud Information Center (NFIC) was originally established in 1992 by the National Consumers League, the oldest nonprofit consumer organization in the United States, to fight the growing menace of telemarketing fraud by improving prevention and enforcement. It maintains a website that provides many useful fraud-related resources.

Address: www.fraud.org/scamsagainstbusinesses/bizscams.htm or go to www.wiley.com/college/kimmel