

CHAPTER 6

ACCOUNTING SYSTEMS, INTERNAL CONTROLS AND CASH

CLASS DISCUSSION QUESTIONS

1. The knowledge that job rotation is practiced and that one employee may perform another's job at a later date tends to discourage deviations from prescribed procedures. Also, rotation helps to disclose any irregularities that may occur.
2. To reduce the possibility of errors and embezzlement, the functions of operations and accounting should be separated. Thus, one employee should not be responsible for handling cash receipts (operations) and maintaining the accounts receivable records (accounting).
3. The control procedure requiring that responsibility for a sequence of related operations be divided among different persons is violated in this situation. This weakness in the internal control may permit irregularities. For example, the ticket seller, while acting as ticket taker, could admit friends without a ticket.
4. Many transactions affect cash, and it is the asset most susceptible to improper diversion and use because of its high value in relation to its mass and its ease of transfer among parties. For these reasons, the control of cash often warrants special attention.
5.
 - a. Cash Short and Over
 - b. Cash shortages are debited to this account.
6. The three documents supporting the liability are vendor's invoice, purchase order, and receiving report. The invoice should be compared with the receiving report to determine that the items billed have been received and with the purchase order to verify quantities, prices, and terms.
7. The prenumbering of checks and the paying of all obligations by check are desirable elements of internal control. The fundamental weakness in internal control is the failure to separate the responsibility for the maintenance of the accounting records (bookkeeping) from the responsibility for operations (payment of obligations).
8.
 - a. In the unpaid voucher file, the vouchers should be filed by the due dates so that each voucher can be paid when due.
 - b. In the paid voucher file, the vouchers should be filed in numerical order so that they can be easily located when needed.
9. The Cash balance and the bank statement balance are likely to differ because of (1) a delay by bank or depositor in recording transactions (such as checks or deposits) or (2) errors by bank or depositor in recording transactions.
10. The purpose of a bank reconciliation is to determine the reasons for the difference between the balance according to the depositor's records and the balance according to the bank statement, and to correct those items representing errors in recording that may have been made by the bank or by the depositor.
11. Additions made by the bank to the depositor's balance
12. Accounts Receivable should be debited and Cash should be credited.
13.
 - a. Petty Cash
 - b. Various expense and asset accounts as indicated by a summary of expenditures
14. The fund should be replenished as of the last day of the period. It is the simplest means of recording the \$690 of expenditures in the appropriate accounts and restoring the amount of the petty cash to the amount shown in the ledger account.
15. Cash and cash equivalents are usually reported as one amount in the Current Assets section of the balance sheet. The details of compensating balances are reported in notes to the financial statements.

EXERCISES

Ex. 6–1

- a. **Agree.** Barbara has made one employee responsible for the cash drawer in accordance with the internal control principle of assignment of responsibility.
- b. **Disagree.** It is commendable that Barbara has given the employee a specific responsibility and is holding that employee accountable for it. However, after the cashier has counted the cash, another employee (or perhaps Barbara) should remove the cash register tape and compare the amount on the tape with the cash in the drawer. Also, Barbara's standard of no mistakes may encourage the cashiers to overcharge a few customers in order to cover any possible shortages in the cash drawer.
- c. **Disagree.** Stealing is a serious issue. An employee who can justify taking a box of tea bags can probably justify "borrowing" cash from the cash register.

Ex. 6–2

- a. The sales clerks could steal money by writing phony refunds and pocketing the cash supposedly refunded to these fictitious customers.
- b.
 1. Elegance by Elaine suffers from inadequate separation of responsibilities for related operations since the clerks issue refunds and restock all merchandise. In addition, there is a lack of proofs and security measures since the supervisors authorize returns two hours after they are issued.
 2. A store credit for any merchandise returned without a receipt would reduce the possibility of theft of cash. In this case, a clerk could only issue a phony store credit rather than taking money from the cash register. A store credit is not as tempting as cash. In addition, sales clerks could only use a few store credits to purchase merchandise for themselves without management getting suspicious.

An advantage of issuing a store credit for returns without a receipt is that the possibility of stealing cash is reduced. The store will also lose less revenue if customers must choose other store merchandise instead of getting a cash refund. The overall level of returns/exchanges may be reduced, since customers will not return an acceptable gift simply because they need cash more than the gift. The policy will also reduce the "cash drain" during the weeks immediately following the holidays, allowing Elegance by Elaine to keep more of its money earning interest or to use that cash to purchase spring merchandise or pay creditors.

Ex. 6–2 Concluded

A disadvantage of issuing a store credit for returns without a receipt is that pre-holiday sales might drop as gift-givers realize that the return policy has tightened. After the holidays, customers wishing to return items for cash refunds may be frustrated when they learn the store policy has changed. The ill will may reduce future sales. It may take longer to explain the new policy and fill out the paperwork for a store credit, lengthening lines at the return counter after the holidays. Sales clerks will need to be trained to apply the new policy and write up a store credit. Sales clerks also will need to be trained to handle the redemption of the store credit on future merchandise purchases.

- 3. The potential for abuse in the cash refund system could be eliminated if clerks were required to get a supervisor’s authorization for a refund before giving the customer the cash. The supervisor should only authorize the refund after seeing both the customer and the merchandise that is being returned.**

An alternative would be to use security measures that would detect a sales clerk attempting to ring up a refund and remove cash when a customer is not present at the sales desk. These security measures could include cameras or additional security personnel discreetly monitoring the sales desk.

Ex. 6–3

As an internal auditor, you would probably disagree with the change in policy. First Charter has some normal business risk associated with default on bank loans. One way to help minimize this is to carefully evaluate loan applications. Large loans present greater risk in the event of default than do smaller loans. Thus, it is reasonable to have more than one person involved in making the decision to grant a large loan. In addition, loans should be granted on their merits, not on the basis of favoritism or mere association with the bank president. Allowing the bank president to have sole authority to grant large loans can lead to the president granting loans to friends and business associates without the required due diligence. This can result in a bank becoming exposed to very poor credit risks. Indeed, this scenario is one of the causes of savings and loan and bank failures of the past.

Ex. 6–4

The Barings Bank fraud shows how small lapses in internal control can have huge consequences. In this case, the “rogue trader” was able to accumulate and hide huge losses. When the losses became so large that they could no longer be hidden, it was too late. This fraud could have been avoided with a number of internal controls. First, and most obvious, the execution and recording of trades should have been separate duties. The trader makes the trades but should never have access to accounting for them. In this way, the actual performance of the trader could not be disguised by “fixing the books.” Second, the trader should be under managerial oversight. For example, trades that exceed a certain amount of exposure should require management approval. In this way, a trader would be forced to slow down or stop once trades reached a certain limit. This would avoid the trader’s tendency to try to “make up” losses with even larger bets. Third, there should be no possibility for unauthorized accounts. All accounts should require formal approval and be set up by individuals other than the trader. Once the account is set up, the accounting should also be separated from the trader. In this way, the trader would not be able to set up a “private” account that goes undetected.

Ex. 6–5

This is an example of a fraud with significant collusion. Frauds that are perpetrated with multiple parties in different positions of control make detecting fraud more difficult. In this case, the fraud began with an employee responsible for authorizing claim payments. This is a sensitive position because his decisions would initiate payments. However, claims would need to be authorized and verified before payment would be made. Knowing this, the employee made sure each claim had a phony “victim.” Thus, there was a verifiable story behind each claim. Only by tracking physical evidence of the accident could it be discovered that the claim was fictitious. However, the very nature of the process was to resolve small claims quickly without excessive control. Lastly, corrupt lawyers were brought into the fraud to act as attorneys for the claimants. This gave the claims even more credibility. In actuality, the lawyers had done legitimate business with the trucking company, so all appeared normal. This fraud was discovered when the fraudulent employee’s bank noticed irregularities in his bank account and notified authorities. As the saying goes, “Follow the money!” As a side note, the corrupt claims administrator fell into this behavior due to gambling problems.

Ex. 6–6

Event Sound should not have relied on the unusual nature of the vendors and delivery frequency to uncover this fraud. The purchase and payment cycle is one of the most critical business cycles to control, because the potential for abuse is so great. Purchases should be initiated by a requisition document. This document should be countersigned by a superior so that two people agree as to what is being purchased. The requisition should initiate a purchase order to a vendor for goods or services. The vendor responds to the purchase order by delivering the goods. The goods should be formally received using a receiving document. An accounts payable clerk matches the requisition, purchase order, and invoice before any payment is made. Such “triple matching” prevents unauthorized requests and payments. In this case, the requests were unauthorized, suggesting that the employee had sole authority to make a request. Second, this employee had access to the invoices. This access allowed the employee to change critical characteristics of the invoice to hide the true nature of the goods being received. The invoice should have been delivered directly to the accounts payable clerk to avoid corrupting the document. There apparently was no receiving document (common for smaller companies); thus, only the invoice provided proof of what was received and to be paid. If there had been a receiving report, the invoice could not have been doctored and gone undetected, because it would not have matched the receiving report.

Note to Instructors: This exercise is based on an actual fraud.

Ex. 6–7

- a. The most difficult frauds to detect are those that involve the senior management of a company that is in a conspiracy to commit the fraud. The senior managers have the power to access many parts of the accounting system, while the normal separation of duties is subverted by involving many people in the fraud. In addition, the authorization control is subverted because most of the authorization power resides in the senior management.
- b. Overall, this type of fraud can be stopped if there is strong oversight of senior management, such as an audit committee of the board of directors. Individual “whistle blowers” in the company can make their concerns known to the independent or internal auditors who, in turn, can inform the audit committee. The audit committee should be independent of management and have the power to monitor the actions of management.

Ex. 6–8

- a. The sales clerks should not have access to the cash register tapes.
- b. The cash register tapes should be locked in the cash register and the key retained by the cashier. An employee of the cashier's office should remove the cash register tape, record the total on the memorandum form, and note discrepancies.

Ex. 6–9

Awesome Burgers suffers from a failure to separate responsibilities for related operations.

Awesome Burgers could stop this theft by limiting the drive-through clerk to taking customer orders, entering them on the cash register, accepting the customers' payments, returning customers' change, and handing customers their orders that another employee has assembled. By making another employee responsible for assembling orders, the drive-through clerk must enter the orders on the cash register. This will produce a printed receipt or an entry on a computer screen at the food bin area, specifying the items that must be assembled to fill each order. Once the drive-through clerk has entered the sale on the cash register, the clerk cannot steal the customer's payment because the clerk's cash drawer will not balance at the end of the shift. This change also makes the drive-through more efficient and could reduce the time it takes to service a drive-through customer.

If another employee cannot be added, the weakness in internal control could be improved with more thorough supervision. The restaurant manager should be directed to keep a watchful eye on the drive-through area in order to detect when a clerk takes an order without ringing up the sale.

Ex. 6–10

- a. The remittance advices should not be sent to the cashier.
- b. The remittance advices should be sent directly to the Accounting Department by the mailroom.

Ex. 6-11

Cash.....	17,572.40	
Cash Short and Over	17.25	
Sales		17,589.65

Ex. 6-12

Cash.....	6,973.60	
Sales		6,932.15
Cash Short and Over		41.45

Ex. 6-13

The use of the voucher system is appropriate, the essentials of which are outlined below. (Although invoices could be used instead of vouchers, the latter more satisfactorily provide for account distribution, signatures, and other significant data.)

1. Each voucher should be approved for payment by a designated official only after completion of the following verifications: (a) that prices, quantities, terms, etc., on the invoice are in accordance with the provisions of the purchase order, (b) that all quantities billed have been received in good condition, as indicated on a receiving report, and (c) that all arithmetic details are correct.
2. The file for unpaid vouchers should be composed of 31 compartments, one for each day of the month. Each voucher should be filed in the compartment representing the last day of the discount period or the due date if the invoice is not subject to a cash discount.
3. Each day, the vouchers should be removed from the appropriate section of the file and checks issued by the disbursing official. If the bank balance is insufficient to pay all of the vouchers, those that remain unpaid should be refiled according to the date when payment should next be considered.
4. At the time of payment, all vouchers and supporting documents should be stamped or perforated "Paid" to prevent their resubmission for payment. They should then be filed in numerical sequence for future reference.

Ex. 6–14

To prevent the embezzlement scheme described, Satchell must separate responsibilities for related operations. As in the past, all service requisitions should be submitted to the Purchasing Department. After receiving the service request, Purchasing should complete a Service Verification form, stating what service has been ordered and the name of the company that will provide the service. This form should be delivered via intercompany mail to the person responsible for verifying that the service was performed. This person should be someone who has firsthand knowledge of whether the service has been performed. This person, who must be someone other than the manager requesting the service, should fill in the date and time the service was received and sign the form. In addition, the vendor providing the service should sign the form before leaving the premises. When completed, the Service Verification form should be forwarded to the Accounting Department. Accounting will authorize payment of the vendor's invoice after the Service Verification form has been compared with the invoice.

Ex. 6–15

- a. Addition to the balance per bank: (4), (6)
- b. Deduction from the balance per bank: (5)
- c. Addition to the balance per depositor's records: (1), (7)
- d. Deduction from the balance per depositor's records: (2), (3)

Ex. 6–16

(1), (2), (3), (7)

Ex. 6-17

KIDSTOCK CO.
Bank Reconciliation
March 31, 20—

<p>Cash balance according to bank statement..... \$ 4,457.25</p> <p>Add deposit in transit, not recorded by bank <u>5,780.40</u></p> <p style="text-align: right;">\$ 10,237.65</p> <p>Deduct outstanding checks <u>2,276.20</u></p> <p>Adjusted balance <u>\$ 7,961.45</u></p>	<p>Cash balance according to depositor's records \$7,671.45</p> <p>Add error in recording check..... <u>306.00</u></p> <p style="text-align: right;">\$7,977.45</p> <p>Deduct bank service charge <u>16.00</u></p> <p>Adjusted balance <u>\$7,961.45</u></p>
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Ex. 6–18

Cash	306.00	
Accounts Payable.....		306.00
Miscellaneous Administrative Expense	16.00	
Cash.....		16.00

Ex. 6–19

Cash	15,300.00	
Notes Receivable.....		15,000.00
Interest Revenue.....		300.00

Ex. 6–20

a.

**DUBITZKY CO.
Bank Reconciliation
July 31, 2006**

Cash balance according to bank statement		\$13,859.87
Add: Deposit in transit on July 31		<u>7,150.00</u>
		\$21,009.87
Deduct: Outstanding checks.....		<u>6,557.12</u>
Adjusted balance		<u>\$14,452.75</u>
Cash balance according to depositor's records.....		\$ 8,100.75
Add: Error in recording Check No. 4217 as \$6,315 instead of \$3,615	\$2,700.00	
Note for \$3,600 collected by bank, including interest	<u>3,672.00</u>	<u>6,372.00</u>
		\$14,472.75
Deduct: Bank service charges		<u>20.00</u>
Adjusted balance		<u>\$14,452.75</u>

b. \$14,452.75

Ex. 6–21

1. The heading should be for April 30, 2006, and not For the Month Ended April 30, 2006.
2. The outstanding checks should be deducted from the balance per bank.
3. The deposit of April 30, not recorded by the bank, should be added to the balance per bank.
4. In deducting the deposit of April 30, not recorded by the bank, the adjusted balance of \$9,637.50 is mathematically incorrect. It should be \$10,637.50.
5. Service charges should be deducted from the balance per depositor's records.
6. The error in recording the April 10 deposit of \$4,850 as \$4,580 should be added to the balance per depositor's records.

A correct bank reconciliation would be as follows:

**IMAGING SERVICES CO.
Bank Reconciliation
April 30, 2006**

Cash balance according to bank statement .		\$ 9,767.76
Add deposit of April 30, not recorded by bank		<u>1,010.06</u>
		\$10,777.82
Deduct outstanding checks:		
No. 821	\$ 345.95	
839	272.75	
843	759.60	
844	<u>501.50</u>	<u>1,879.80</u>
Adjusted balance		<u>\$ 8,898.02</u>
Cash balance according to depositor's records.....		
		\$ 1,118.32
Add: Proceeds of note collected by bank:		
Principal.....	\$8,000.00	
Interest	<u>280.00</u>	\$8,280.00
Error in recording April 10 deposit as \$4,580 instead of \$4,850		
	<u>270.00</u>	<u>8,550.00</u>
		\$ 9,668.32
Deduct: Check returned because of insufficient funds		
	\$ 752.30	
Service charges.....	<u>18.00</u>	<u>770.30</u>
Adjusted balance		<u>\$ 8,898.02</u>

Ex. 6–22

- a. The amount of cash receipts stolen by the sales clerk can be determined by attempting to reconcile the bank account. The bank reconciliation will not reconcile by the amount of cash receipts stolen. The amount stolen by the sales clerk is \$6,207.18, determined as shown below.

**PROMETHEUS CO.
Bank Reconciliation
April 30, 2006**

Cash balance according to bank statement	\$13,271.14
Deduct: Outstanding checks.....	<u>1,750.20</u>
Adjusted balance	<u>\$11,520.94</u>
Cash balance according to depositor's records.....	\$12,573.22
Add: Note collected by bank, including interest.....	<u>5,200.00</u>
	\$17,773.22
Deduct: Bank service charges	<u>45.10</u>
Adjusted balance	<u>\$17,728.12</u>

Amount stolen: \$6,207.18 (\$17,728.12 – \$11,520.94)

- b. The theft of the cash receipts might have been prevented by having more than one person make the daily deposit. Collusion between two individuals would then have been necessary to steal cash receipts. In addition, two employees making the daily cash deposits would tend to discourage theft of the cash receipts from the employees on the way to the bank.

Daily reconciliation of the amount of cash receipts, comparing the cash register tapes to a receipt from the bank as to the amount deposited (a duplicate deposit ticket), would also discourage theft of the cash receipts. In this latter case, if the reconciliation were prepared by an employee independent of the cash function, any theft of cash receipts from the daily deposit would be discovered immediately. That is, the daily deposit would not reconcile against the daily cash receipts.

Ex. 6–23

a.	Petty Cash	750.00	
	.....Cash		750.00
b.	Office Supplies.....	415.83	
	Miscellaneous Selling Expense.....	107.90	
	Miscellaneous Administrative Expense.....	88.10	
	Cash Short and Over	18.60	
	.....Cash		630.43

Ex. 6–24

Retailers experience a seasonal trend in cash and cash equivalents. Circuit City's lowest level of cash flows is in the fall, when merchandise that has been ordered for the holiday season must be paid for. During the remainder of the year, Circuit City has higher levels of cash and cash equivalents. Its cash and cash equivalents peak in May, just prior to the fall buying season.

Ex. 6–25

a. 2003: 0.27 ($\$2,188,000,000 \div \$8,035,000,000$)

2002: 0.38 ($\$2,477,000,000 \div \$6,501,000,000$)

b. The doomsday ratio is normally less than one. Although there is little risk of Home Depot going out of business, the trend from 2002 to 2003 indicates less safety for short-term creditors. The doomsday ratio is most useful for companies that are likely to enter bankruptcy.

PROBLEMS

Prob. 6–1A

Strengths: a, b, e, and g

Weaknesses:

- c. Cash receipts should not be handled by the accounts receivable clerk. This violates the segregation of duties between the handling of cash receipts and the recording of cash receipts.**
- d. An independent person (for example, a supervisor) should count the cash in each cashier's cash register, unlock the record, and compare the amount of cash with the amount on the record to determine cash shortages or overages.**
- f. The bank reconciliation should be prepared by someone not involved with the handling or recording of cash.**

Prob. 6–2A

2006

June	1	Petty Cash	600.00	
		.....Cash		600.00
	6	Cash	8,008.15	
		.....Cash Short and Over		9.65
		.....Sales		7,998.50
	30	Store Supplies.....	30.75	
		Merchandise Inventory	166.25	
		Office Supplies.....	161.50	
		Miscellaneous Administrative Expense.....	179.50	
		Cash Short and Over	11.25	
		.....Cash		549.25
	30	Cash	8,988.35	
		Cash Short and Over	21.15	
		.....Sales		9,009.50
	30	Cash	150.00	
		.....Petty Cash		150.00

Prob. 6–3A

1.

**SHOWTIME SYSTEMS
Bank Reconciliation
February 28, 2006**

Cash balance according to bank statement		\$31,391.40
Add deposit of February 28, not recorded by bank		<u>6,215.50</u>
		\$37,606.90
Deduct: Outstanding checks.....	\$11,021.50	
Bank error in charging check as \$585 instead of \$855	<u>270.00</u>	<u>11,291.50</u>
Adjusted balance		<u>\$26,315.40</u>
Cash balance according to depositor's records.....		\$19,144.15
Add: Proceeds of note collected by bank, including \$300 interest	\$ 6,300.00	
Error in recording check.....	<u>900.00</u>	<u>7,200.00</u>
		\$26,344.15
Deduct bank service charges.....		<u>28.75</u>
Adjusted balance		<u>\$26,315.40</u>
 2. Cash.....	 7,200.00	
Notes Receivable		6,000.00
Interest Revenue		300.00
Accounts Payable—Wilson Co.		900.00
Miscellaneous Administrative Expense.....	28.75	
Cash.....		28.75

Prob. 6–4A

1.

**ALPINE SPORTS CO.
Bank Reconciliation
April 30, 2006**

Balance per bank statement.....		\$18,880.45
Add deposit of April 30, not recorded by bank		<u>3,481.70</u>
		\$22,362.15
Deduct: Outstanding checks.....	\$ 5,180.27	
Bank error in charging check as \$260 instead of \$620.....	<u>360.00</u>	<u>5,540.27</u>
Adjusted balance		<u>\$16,821.88</u>
Balance per depositor's records		\$14,284.88*
Add: Proceeds of note collected by bank, including \$224 interest	\$ 3,424.00	
Error in recording check	<u>18.00</u>	<u>3,442.00</u>
		\$17,726.88
Deduct: Check returned because of insufficient funds	\$ 880.00	
Bank service charges	<u>25.00</u>	<u>905.00</u>
Adjusted balance		<u>\$16,821.88</u>
*Cash balance, April 1	\$16,911.95	
Plus cash deposited in April	65,500.40	
Less checks written in April.....	<u>(68,127.47)</u>	
Balance per depositor's records, April 30	<u>\$14,284.88</u>	
2. Cash.....	3,442.00	
Notes Receivable		3,200.00
Interest Revenue		224.00
Accounts Payable—Bray & Son		18.00
Accounts Receivable—Shuler Co.	880.00	
Miscellaneous Administrative Expense.....	25.00	
Cash		905.00

Prob. 6–5A

1.

ROCKY MOUNTAIN INTERIORS
Bank Reconciliation
May 31, 20—

Cash balance according to bank statement		\$14,145.54
Add deposit of May 31, not recorded by bank.....		<u>1,325.05</u>
		\$15,470.59
Deduct outstanding checks:		
No. 602	\$ 85.50	
628	837.70	
634	<u>303.30</u>	<u>1,226.50</u>
Adjusted balance		<u>\$14,244.09</u>
Cash balance according to depositor's records.....		\$ 8,531.99*
Add proceeds of note collected by bank:		
Principal	\$ 5,000.00	
Interest	400.00	
Add error in recording Check No. 632.....	<u>561.60</u>	<u>5,961.60</u>
		\$14,493.59
Deduct: Check returned because of insufficient funds..		
Service charges	\$ 225.40	
	<u>24.10</u>	<u>249.50</u>
Adjusted balance		<u>\$14,244.09</u>
*Balance per cash in bank account, May 1	\$10,578.00	
Add May receipts	6,630.60	
Deduct May disbursements.....	<u>(8,676.61)</u>	
Balance per cash in bank account, May 31.....	<u>\$ 8,531.99</u>	

2.	Cash	5,961.60	
	Notes Receivable		5,000.00
	Interest Revenue		400.00
	Accounts Payable		561.60
	Accounts Receivable	225.40	
	Miscellaneous Administrative Expense	24.10	
	Cash		249.50

3. \$14,244.09

4. The error of \$360 in the canceled check should be added to the “balance according to bank statement” on the bank reconciliation. The canceled check should be presented to the bank, with a request that the bank balance be corrected.

Prob. 6–1B

Strengths: a, e, g, and h

Weaknesses:

- b. The bank reconciliation should be prepared by someone not involved with the handling or recording of cash.**
- c. Requiring cash register clerks to make up any cash shortages from their own funds gives the clerks an incentive to short-change customers. That is, the clerks will want to make sure that they don't have a shortage at the end of the day. In addition, one might also assume that the clerks can keep any overages. This would again encourage clerks to short-change customers. The short-changing of customers will create customer complaints, etc. The best policy is to report any cash shortages or overages at the end of each day. If a clerk is consistently short or over, then corrective action (training, removal, etc.) could be taken.**
- d. Employees should not be allowed to use the petty cash fund to cash personal checks. In any case, post-dated checks should not be accepted. In effect, post-dated checks represent a receivable from the employees.**
- f. The mail clerk should prepare an initial listing of cash remittances before forwarding the cash receipts to the cashier. This establishes initial accountability for the cash receipts. The mail clerk should forward a copy of the listing of remittances to the accounts receivable clerk for recording in the accounts.**

Prob. 6–2B

2006

Mar.	1	Petty Cash	850.00	
		.....Cash		850.00
	18	Cash	12,007.50	
		.....Cash Short and Over		36.90
		.....Sales		11,970.60
	31	Store Supplies.....	198.10	
		Transportation Out	245.00	
		Office Supplies.....	178.20	
		Miscellaneous Administrative Expense	190.00	
		Cash Short and Over	18.52	
		.....Cash		829.82
	31	Cash	9,010.25	
		Cash Short and Over	45.25	
		.....Sales		9,055.50
	31	Petty Cash	100.00	
		.....Cash		100.00

Prob. 6–3B

1.

**PICKRON CO.
Bank Reconciliation
April 30, 2006**

Cash balance according to bank statement		\$18,016.30
Add: Deposit of April 30, not recorded by bank	\$ 5,189.40	
Bank error in charging check as \$1,860 instead of \$1,680	180.00	5,369.40
		\$23,385.70
Deduct outstanding checks		7,169.75
Adjusted balance		\$16,215.95
Cash balance according to depositor's records		\$13,290.95
Add proceeds of note collected by bank, including \$240 interest		3,240.00
		\$16,530.95
Deduct: Error in recording check.....	\$ 270.00	
Bank service charges	45.00	315.00
Adjusted balance		\$16,215.95
2. Cash	3,240.00	
Notes Receivable		3,000.00
Interest Revenue		240.00
Accounts Payable—Jones Co.	270.00	
Miscellaneous Administrative Expense	45.00	
Cash		315.00

Prob. 6–4B

1.

**SEAL-TEK CO.
Bank Reconciliation
December 31, 2006**

Balance per bank statement.....		\$ 5,465.50
Add: Deposit of December 31 not recorded by bank....	\$ 2,148.21	
Bank error in charging check as \$1,200 instead of \$120	1,080.00	3,228.21
		\$ 8,693.71
Deduct outstanding checks		3,003.84
Adjusted balance		\$ 5,689.87
Balance per depositor's records		\$ 4,627.87*
Add proceeds of note collected by bank, including \$108 interest		1,908.00
		\$ 6,535.87
Deduct: Check returned because of insufficient funds	\$ 636.00	
Bank service charges	30.00	
Error in recording check.....	180.00	846.00
Adjusted balance		\$ 5,689.87
*Cash balance, December 1	\$ 3,945.90	
Plus cash deposited in December	31,077.75	
Less checks written in December	(30,395.78)	
Balance per depositor's books, December 31	\$ 4,627.87	
2. Cash	1,908.00	
Notes Receivable		1,800.00
Interest Revenue		108.00
Accounts Payable—Kenyon Co.	180.00	
Accounts Receivable—Fontana Co.	636.00	
Miscellaneous Administrative Expense	30.00	
Cash		846.00

Prob. 6–5B

1.

HERITAGE FURNITURE COMPANY
Bank Reconciliation
November 30, 20—

Cash balance according to bank statement .		\$11,091.76
Add deposit of November 29, not recorded by bank		<u>1,010.06</u>
		\$12,101.82
Deduct outstanding checks:		
No. 736	\$ 345.95	
755	272.75	
758	259.60	
759	<u>901.50</u>	<u>1,779.80</u>
Adjusted balance		<u>\$10,322.02</u>
Cash balance according to depositor's records.....		
		\$ 7,863.32*
Add: Proceeds of note collected by bank:		
Principal.....	\$2,500.00	
Interest	<u>125.00</u>	\$2,625.00
Error in recording November 22 deposit	<u>360.00</u>	<u>2,985.00</u>
		\$10,848.32
Deduct: Check returned because of insufficient funds.....		
Error in recording Check No. 752....	\$ 291.90	
Service charges	200.00	
	<u>34.40</u>	<u>526.30</u>
Adjusted balance		<u>\$10,322.02</u>
*Balance per cash account, November 1.....		
		\$ 7,317.40
Add November receipts.....		8,651.58
Deduct November disbursements		<u>(8,105.66)</u>
		<u>\$ 7,863.32</u>

Prob. 6–5B Concluded

2.	Cash	2,985.00
	.....Notes Receivable	
	2,500.00	
	.....Interest Revenue	
	125.00	
	.....Sales	
	360.00	
	Accounts Payable	200.00
	Accounts Receivable.....	291.90
	Miscellaneous Administrative Expense.....	34.40
	.....Cash	
	526.30	

3. \$10,322.02

4. The error of \$270 in the canceled check should be added to the “balance according to bank statement” on the bank reconciliation. The canceled check should be presented to the bank, with a request that the bank balance be corrected.

SPECIAL ACTIVITIES

Activity 6–1

- a. Based on Garrett’s knowledge of the situation, Garrett was not acting in the best interests of his employer but was acting in his own short-term best interests. Thus, Garrett was not acting in an ethical manner. Garrett could still have had the sale by insisting on cash up front, rather than performing the service on account. Moreover, this contract may come back to haunt Garrett in the long term, once the company determines that the account cannot be collected after the security system has been installed. Garrett may have to answer for this decision.
- b. Guardsman management has placed Garrett in a short-term dilemma by requiring him to act contrary to his own short-term best interests. Guardsman Security Co. could avoid this scenario by establishing a separate credit department. All potential contracts could be referred from the field salesperson to the credit office. If credit is approved, then the sale is credited to the salesperson for purposes of quota determination. If credit is not approved, then a contract is not signed. This is an example of separation of duties (sales are separated from credit authorization). Another approach would be to determine the quota on the basis of collections, rather than sales. In this way, the salesperson would be more concerned about the eventual collection of a sale.

Activity 6–2

- a. Employees are responsible for their own decisions, even if they are “following orders.” A “following orders” defense will not be successful in a criminal court proceeding. Often prosecutors will offer plea agreements to midlevel managers in return for cooperation and testimony against superiors. Such pleas do not remove legal jeopardy but can reduce the penalty at sentencing.
- b. An employee facing pressure to conduct unethical or illegal requests from superiors has very few options. Going along with these requests will not remove legal jeopardy (see a.). Employees facing such pressure may:
 - (1) quit and find another job.
 - (2) refuse to cooperate with the requests, thereby risking their jobs and career advancement.
 - (3) report the behavior or issues to an oversight authority, such as the audit committee of the board of directors or other ombudsmen office established within the company for such reports.
 - (4) report the behavior or issues to the CEO (unless the CEO is approving these actions).

Activity 6–3

Acceptable business and professional conduct requires Chris Renees to notify the bank of the error. *Note to Instructors:* Individuals may be criminally prosecuted for knowingly using funds that are erroneously credited to their bank accounts.

Activity 6–4

Several control procedures could be implemented to prevent or detect the theft of cash from fictitious returns.

One procedure would be to establish a policy of “no cash refunds.” That is, returns could only be exchanged for other merchandise. However, such a policy might not be popular with customers, and Reboot Electronics might lose sales from customers who would shop at other stores with a more liberal return policy.

Another procedure would be to allow returns only through a centralized location, such as a customer service desk. The customer service desk clerk would issue an approved refund slip, which the customer could then take to a cash register to receive a cash refund. Since the customer service clerk does not have access to cash, the customer service clerk could not steal cash through fictitious returns.

Yet another procedure would be to allow returns at the individual cash registers but require that all returns be approved by a supervisor. In this way, cash could be stolen through fictitious returns only with collusion of the supervisor and the cash register clerk.

Activity 6–5

Several possible procedures for preventing or detecting the theft of grocery items by failing to scan their prices include the following:

- a. Most scanning systems are designed so that an audible beep is heard each time an item is rung up on the cash register. This is intended to alert the cashier that the item has been properly rung up. Thus, observing whether a cashier is ringing up all merchandise can be accomplished by standing near the cash register and listening for the beeps. Such observations might be done on a periodic, surprise basis by supervisors.
- b. Some grocery stores have their cash registers networked so that a monitor in a centralized office, usually high above the floor, can monitor any cash register's activity. In this way, a supervisor could monitor cash register activity on a periodic basis.
- c. Although this detection procedure would probably not be used in a grocery store, it is used by Sam's Clubs to detect this activity. Specifically, an employee is stationed at the exit to the store and checks each cash register receipt against the items with which the customer is leaving the store. This would not work well for a grocery store because of the large number of items that are usually placed in grocery bags at the checkout counter.

Activity 6–6

Kerri is clearly behaving in an unprofessional manner in intentionally short-changing her customers.

At this point, Tim is in a difficult position. He is apparently adhering to Frontier Markets' policy of making up shortages out of his own pocket, but he is obviously upset about it. If Tim accepts Kerri's advice, he will be engaging in unprofessional behavior. Tim is also faced with the dilemma of whether he should report Kerri's behavior. If Tim continues to work for Frontier Markets, his best course of action is simply to try to do the best job possible in not making errors in ringing up sales and providing customers change.

One could argue that Rostad is also acting in an unprofessional manner. First, allowing Kerri to keep overages will simply encourage her to continue to short-change customers. Second, since Kerri has had no shortages in over a year, it should be obvious to Rostad that Kerri is short-changing customers. Therefore, as store manager, Rostad should take action to stop Kerri's behavior. Better yet, Rostad should consider revising Frontier Markets' control policy on shortages and overages. The cash register clerks should be required to report all shortages and overages without having to make up shortages from their own pockets. The cash register clerks could then be monitored for their effectiveness in making change for customers. Unusual amounts or trends could be investigated and corrective action taken, such as training, reassigning employees to other duties, etc. In any case, employees should not be allowed to keep overages at the end of each day.

Activity 6–7

1. There are several methods that could be used to determine how much the cashier has stolen. The method described below is based on preparing a bank reconciliation as illustrated in this chapter. Because of the theft of the undeposited receipts, the bank reconciliation adjusted balances will not agree. The difference between the adjusted balances is the estimate of the amount stolen by the cashier.

LUMBERJACK COMPANY
Bank Reconciliation
July 31, 20—

Balance according to bank statement.....		\$ 6,004.95
Add undeposited cash receipts on hand		<u>5,000.00</u>
		\$11,004.95
Deduct outstanding checks:		
No. 670	\$781.20	
679	610.00	
690	716.50	
1996	127.40	
1997	520.00	
1999	<u>851.50</u>	<u>3,606.60</u>
Adjusted balance		<u>\$ 7,398.35</u>
Balance according to depositor's records		\$ 9,806.05
Add note collected by bank, with interest		<u>4,240.00</u>
Adjusted balance		<u>\$14,046.05</u>
Adjusted balance according to depositor's records		\$14,046.05
Adjusted balance according to bank statement.....		<u>7,398.35</u>
Amount stolen by cashier.....		<u>\$ 6,647.70</u>

Note to Instructors: The amount stolen by the cashier could also be computed directly from the cashier-prepared bank reconciliation as follows:

Outstanding checks omitted from the bank reconciliation prepared by the cashier:		
No. 670	\$781.20	
679	610.00	
690	<u>716.50</u>	\$ 2,107.70
Unrecorded note plus interest incorrectly recorded on the bank reconciliation prepared by the cashier.....		4,240.00
Addition error in the total of the outstanding checks in the bank reconciliation prepared by the cashier*		<u>300.00</u>
		<u>\$ 6,647.70</u>

***Note: The cashier has altered the adding machine tape so that the total is not correct.**

Activity 6–7 Concluded

2. The cashier attempted to conceal the theft by preparing an incorrect bank reconciliation. Specifically, the cashier (1) omitted outstanding checks on July 31 totaling \$2,107.70, (2) added the list of outstanding checks shown on the bank reconciliation incorrectly so that the total is misstated by \$300, and (3) incorrectly handled the treatment of the note and interest collected by the bank.
3. a. Two major weaknesses in internal controls, which allowed the cashier to steal the undeposited cash receipts, are as follows:
 - Undeposited cash receipts were kept on hand for a two-day period, July 30 and 31. This large amount of undeposited cash receipts allowed the cashier to steal the cash without arousing suspicion that any cash was missing.
 - The cashier prepared the bank reconciliation. This allowed the cashier to conceal the theft temporarily.
- b. Two recommendations that would improve internal controls so that similar types of thefts of undeposited cash receipts could be prevented are as follows:
 - All cash receipts should be deposited daily. This would reduce the risk of significant cash losses. In addition, any missing cash would be more easily detected.
 - The bank reconciliation should be prepared by an independent individual who does not handle cash or the accounting records. One possibility would be for the owner of Lumberjack Company to prepare the reconciliation.

Note to Instructors: In addition to the above recommendations, Lumberjack Company should be counseled that it is standard practice for any disgruntled employees, fired employees, or employees who have announced quitting dates to be removed from sensitive positions (such as the cashier position) so that company assets or records will not be jeopardized. Finally, checks which have been outstanding for long periods of time (such as Nos. 670, 679, and 690) should be voided (with stop payment instructions given to the bank) and reentered in the cash records. This establishes control over these items and prevents their misuse.

Activity 6–8

Note to Instructors: The purpose of this activity is to familiarize students with the internal controls used by specific businesses.

Activity 6–9

Note to Instructors: The purpose of this activity is to familiarize students with the options that are available for savings and checking accounts.