

Introduction to Accounting 2

Modul 1

Internal Control and Cash

After studying this chapter, you should be able to:

1. Describe the Sarbanes-Oxley Act of 2002 and its impact on internal controls and financial reporting.
2. Define internal control.
3. Identify the principles of internal control.
4. Explain the applications of internal control principles to cash receipts.
5. Explain the applications of internal control principles to cash disbursements.
6. Describe the operation of a petty cash fund.
7. Indicate the control features of a bank account.
8. Prepare a bank reconciliation.
9. Explain the reporting of cash.

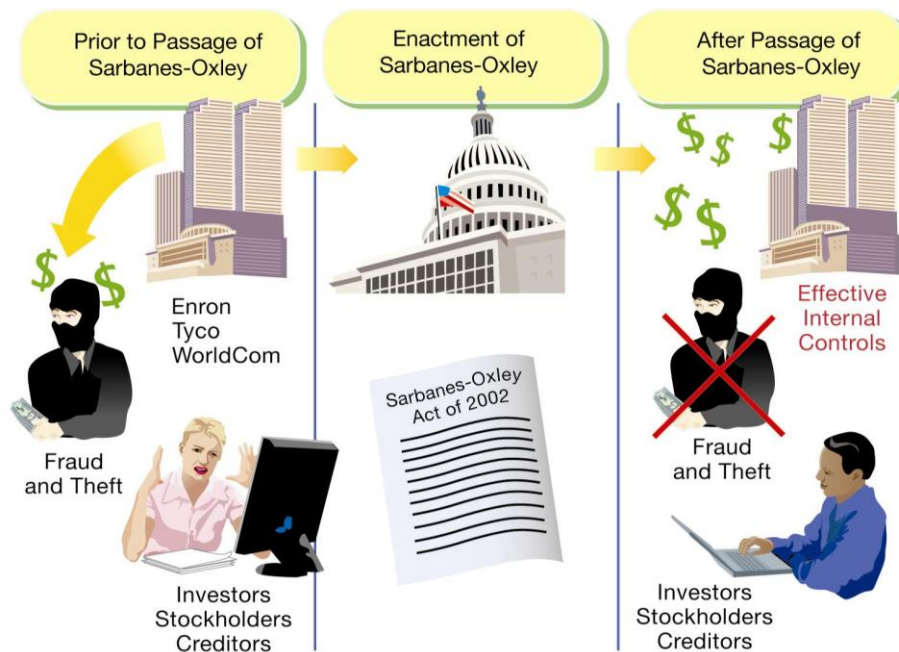
STUDY OBJECTIVE 1: DESCRIBE THE SARBANES-OXLEY ACT OF 2002 AND ITS IMPACT ON INTERNAL CONTROLS AND FINANCIAL REPORTING.

The *Sarbanes-Oxley Act of 2002* (referred to simply as *Sarbanes-Oxley*) applies only to companies whose stock is traded on public exchanges. Its purpose is to restore public confidence and trust in the financial statements of companies. Sarbanes-Oxley requires companies to maintain strong and effective *internal control*.

Sarbanes-Oxley Act:

- Public companies must issue internal control report
- Independent auditor must evaluate internal controls
- Created Public Company Accounting Oversight Board – oversees work of auditors of public companies
- Accounting firms may not both audit and provide certain consulting services for the same client
- Established penalties for violators

Effect of Sarbanes-Oxley Act



As a company that listed on the New York Stock Exchange, Telkom is obliged to comply with all existing rules, including the Sarbanes Oxley Act (SOA). The SOA requires internal control over the financing reporting and guarantee from Telkom's management that all information in the financial report is accurate and can be accounted for. To meet the SOA requirement, Telkom has conducted internal improvement through organizational transformation and the application of Good Corporate Governance (GCG) policies. The internal control over the financing reporting has become the priority for improving the system.

STUDY OBJECTIVE 2: INTERNAL CONTROL

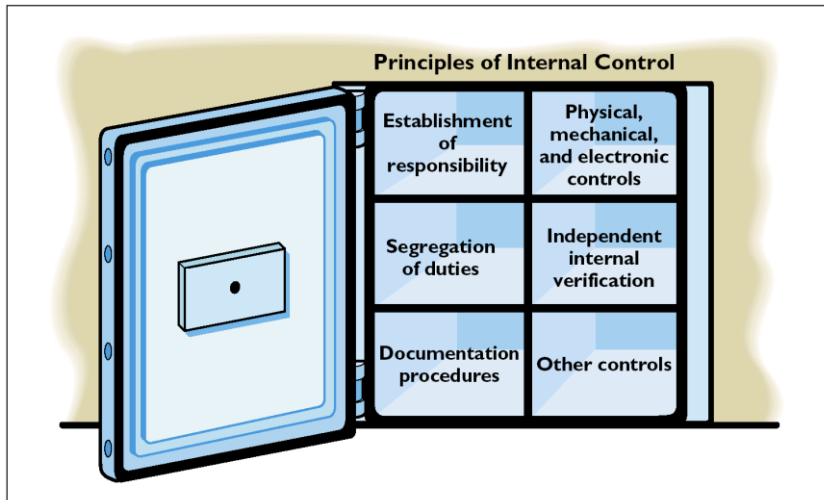
Internal control is broadly defined as the procedures and processes used by a company to safeguard its assets, process information accurately, and ensure compliance with laws and regulations.

Internal Control

1. Safeguards an organization's assets

2. Enhances the accuracy and reliability of accounting records

STUDY OBJECTIVE 3: PRINCIPLES OF INTERNAL CONTROL

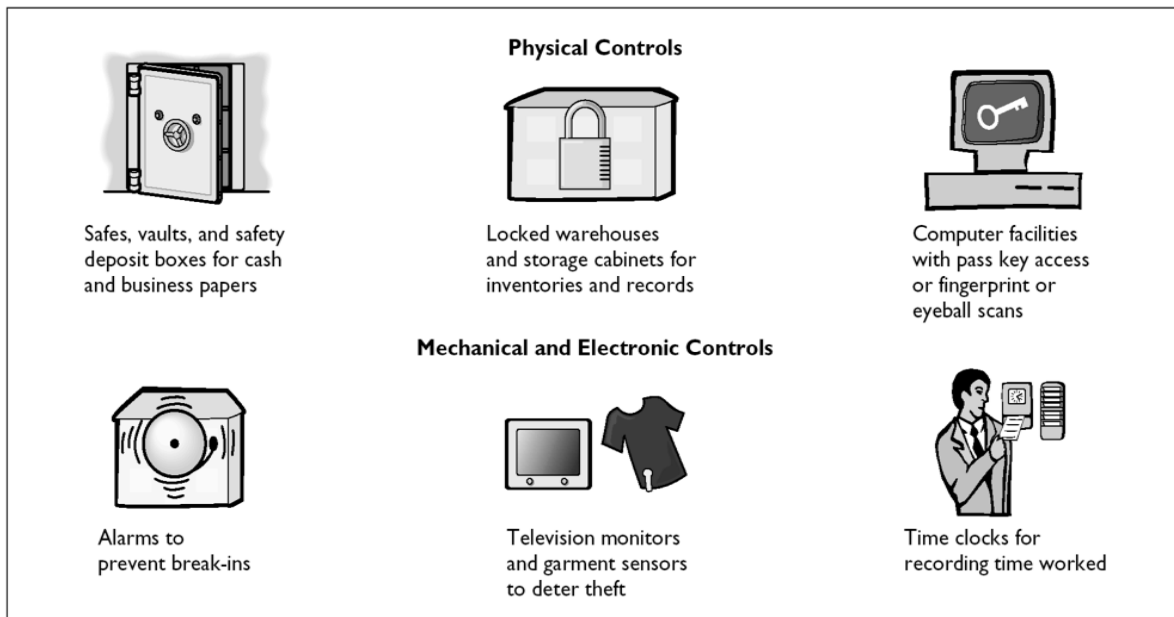


PRINCIPLES OF INTERNAL CONTROL

- Establishment of responsibility:
Most effective when only one person is responsible for a given task
- Segregation of duties:
The work of one employee should provide a reliable basis for evaluating the work of another employee
- Documentation procedures:
Documents provide evidence that transactions and events have occurred
- Physical, mechanical, and electronic controls:
Safeguarding of assets and enhancing accuracy and reliability of the accounting records.
- Independent internal verification:
The review, comparison, and reconciliation of information from two sources.
- Other controls:
Bonding of employees who handle cash, rotating employee's duties, and requiring employees to take vacations.

PHYSICAL, MECHANICAL, AND ELECTRONIC CONTROLS

- ◆ Locked warehouses and storage cabinets for inventories and records
- ◆ Safes, vaults, and safety deposit boxes for cash and business papers
- ◆ Time clocks for recording time worked
- ◆ Computer facilities with pass key access
- ◆ Alarms to prevent break-ins
- ◆ Television monitors and garment sensors to deter theft



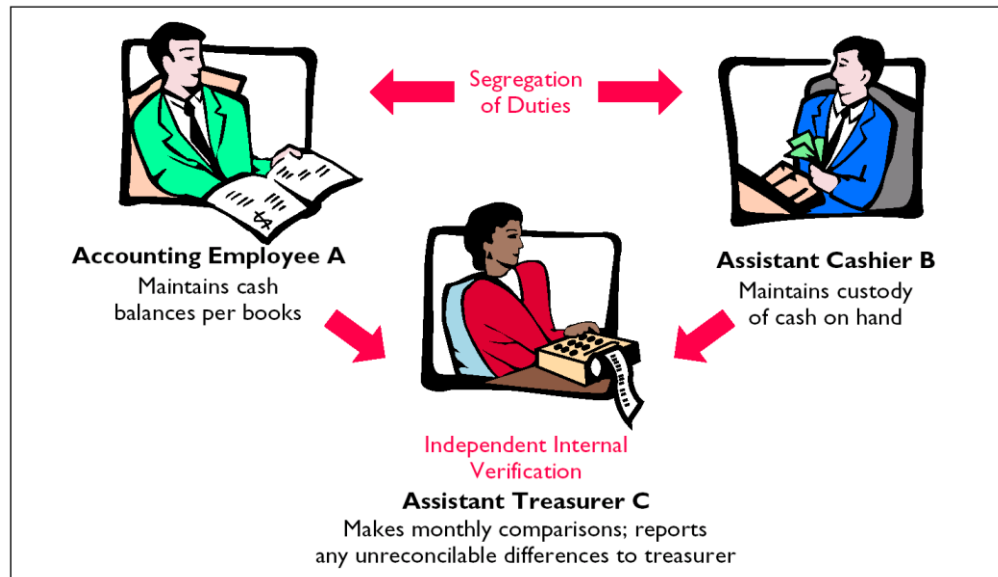
INDEPENDENT INTERNAL VERIFICATION

Maximum benefit

Independent internal verification:

1. Made on periodic or surprise basis
2. Should be done by someone who is independent of the employee responsible for the information
3. Report discrepancies and exceptions to a management level that can take appropriate corrective action

COMPARISON OF SEGREGATION OF DUTIES PRINCIPLE WITH INDEPENDENT INTERNAL VERIFICATION PRINCIPLE



LIMITATIONS OF INTERNAL CONTROL

- ◆ Costs of establishing control procedures should not exceed their expected benefits
- ◆ The human element is an important factor in every system of internal control. A good system can become ineffective through employee fatigue carelessness, or indifference.
- ◆ Collusion may result.
Two or more individuals work together to get around prescribed controls and may significantly impair the effectiveness of a system.

CASH

- ◆ **Cash**: Coins, currency, checks, money orders, and money on hand or on deposit at a bank or similar depository
- ◆ Internal control over cash is imperative
Safeguards cash and assure the accuracy of the accounting records for cash

STUDY OBJECTIVE 4: CONTROL OVER CASH RECEIPTS

- Only designated personnel should be authorized to handle or have access to cash receipts.
- Different individuals should:
 1. receive cash
 2. record cash receipt transactions
 3. have custody of cash

CONTROL OVER CASH RECEIPTS

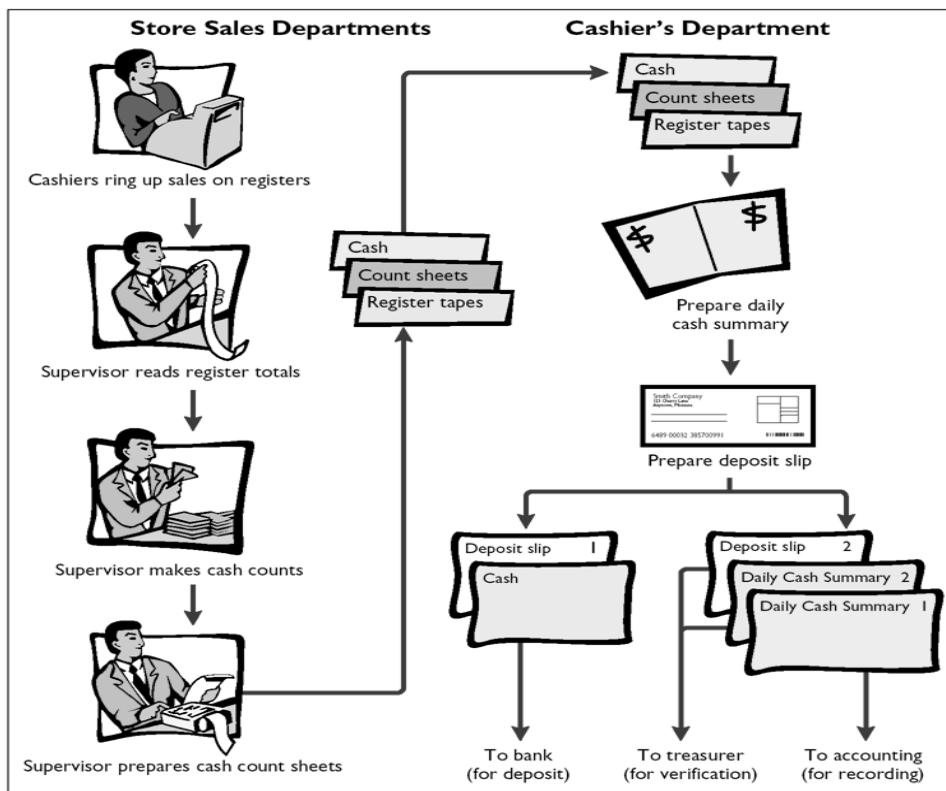
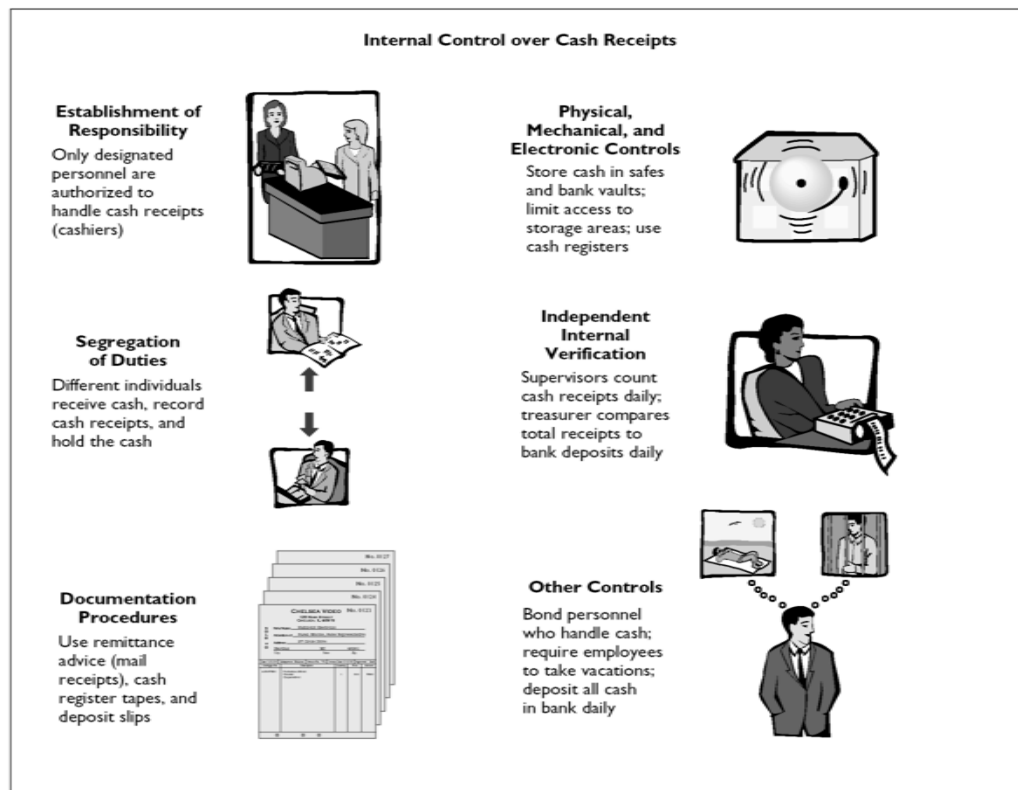
- Documents should include:
 1. Remittance advices
 2. Cash register tapes
 3. Deposit slips
- Cash should be stored in safes and bank vaults
- Access to storage areas should be limited to authorized personnel
- Cash registers should be used in executing over-the-counter receipts

CONTROL OVER CASH RECEIPTS

Store No. <u>8</u>	Date <u>March 8, 2008</u>
<hr/>	
1. Opening cash balance	\$ 50.00
2. Cash sales per tape (attached)	<u>6,956.20</u>
3. Total cash to be accounted for	7,006.20
4. Cash on hand (see list)	<u>6,996.10</u>
5. Cash (short) or over	<u>\$ (10.10)</u>
6. Ending cash balance	<u>\$ 50.00</u>
7. Cash for deposit (Line 4 – Line 6)	<u>96,946.10</u>
Cashier <u>J. Cruise</u>	Supervisor <u>M. Braun</u>

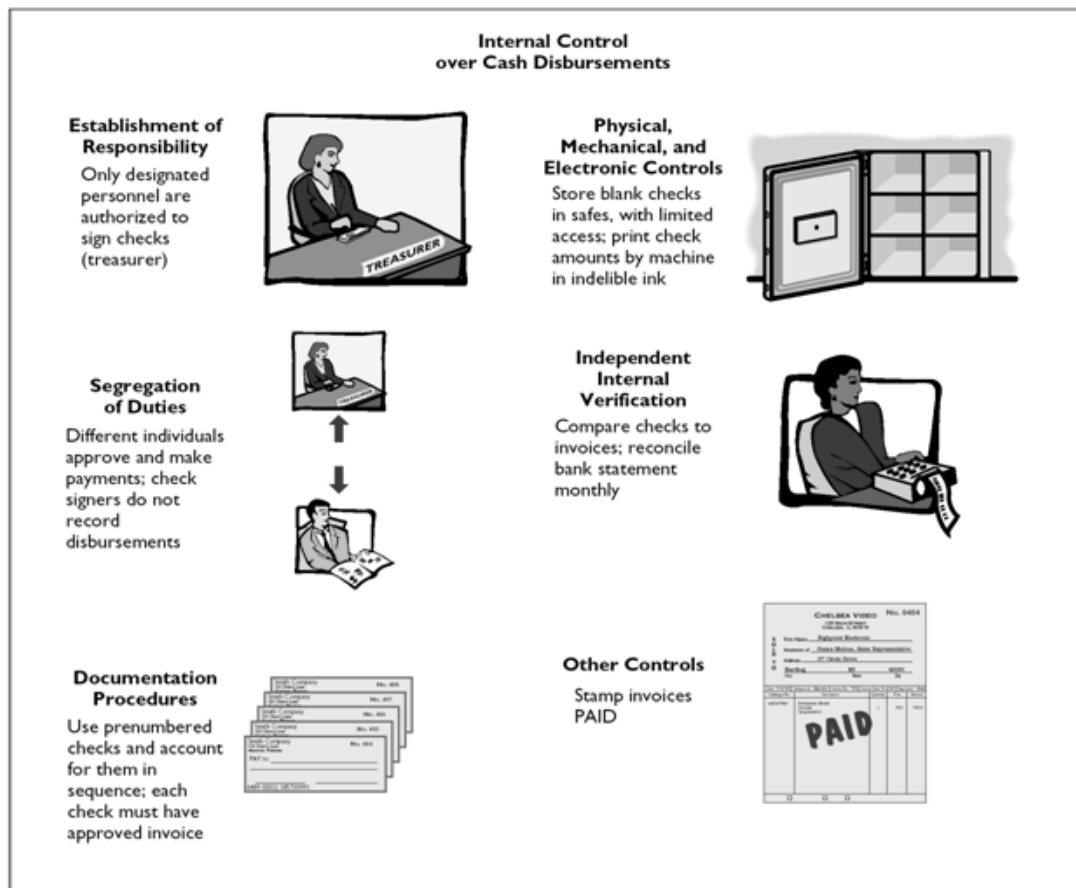
- Daily cash counts and daily comparisons of total receipts.
- All personnel who handle cash receipts should be bonded and required to take vacations.

- Control of over-the-counter receipts is centered on cash registers that are visible to customers.



STUDY OBJECTIVE 5: CONTROL OVER CASH DISBURSEMENTS

- Payments are made by check rather than by cash, except for petty cash transactions.
- Only specified individuals should be authorized to sign checks.
- Different departments or individuals should be assigned the duties of approving an item for payment and paying it.
- Prenumbered checks should be used and each check should be supported by an approved invoice or other document.
- Blank checks should be stored in a safe.
 1. Access should be restricted to authorized personnel.
 2. A check writer machine should be used to imprint the amount on the check in indelible ink.
- Each check should be compared with the approved invoice before it is issued.
- Following payment, the approved invoice should be stamped “PAID”.



VOUCHER SYSTEM

- ◆ The voucher system
 - ◆ Is often used to enhance the internal control over cash disbursements.
 - ◆ Is an extensive network of approvals by authorized individuals acting independently to ensure that all disbursements by check are proper.
- ◆ A voucher is an authorization form prepared for each expenditure.
- ◆ Vouchers are recorded in a journal called the voucher register.

ELECTRONIC FUNDS TRANSFER SYSTEM

- Checks processing is expensive
New methods are being developed to transfer funds among parties without the use of paper
- Electronic Funds Transfer (EFT) System A disbursement system that uses wire, telephone, telegraph, or computer to transfer cash from one location to another

STUDY OBJECTIVE 6: PETTY CASH FUND

- ◆ A petty cash fund is used to pay relatively small amounts
- ◆ Operation of the fund, often called an imprest system, involves:
 1. Establishing the fund
 2. Making payments from the fund
 3. Replenishing the fund
- ◆ Accounting entries are required when:
 1. The fund is established
 2. The fund is replenished
 3. The amount of the fund is changed

ESTABLISHING THE FUND

- Two essential steps in establishing a petty cash fund are:
 1. appointing a petty cash custodian who will be responsible for the fund and
 2. determining the size of the fund.

- Ordinarily, the amount is expected to cover anticipated disbursements for a 3 to 4 week period.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Mar. 1	Petty Cash Cash (To establish a petty cash fund)		

When the fund is established, a check payable to the petty cash custodian is issued for the stipulated amount

REPLENISHING THE FUND

- ◆ When the money in the petty cash fund reaches a minimum level, the fund is replenished.
- ◆ The request for reimbursement is initiated by the petty cash custodian.
- ◆ The petty cash custodian prepares a schedule of the payments that have been made and sends the schedule, with supporting documentation, to the treasurer's office.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Mar. 15	Postage Expense Freight-out Miscellaneous Expense Cash (To replenish petty cash fund)		

On March 15 the petty cash custodian requests a check for \$87. The fund contains \$13 cash and petty cash receipts for postage, \$44, freight-out, \$38, and miscellaneous expenses, \$5.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Mar. 15	Postage Expense Freight-out Miscellaneous Expense Cash Over and Short Cash (To replenish petty cash fund)		

On March 15 the petty cash custodian requests a check for \$88. The fund contains \$12 cash and petty cash receipts for postage, \$44, freight-out, \$38, and miscellaneous expenses, \$5.

STUDY OBJECTIVE 7: USE OF A BANK

The use of a bank minimizes the amount of currency that must be kept on hand and contributes significantly to good internal control over cash.

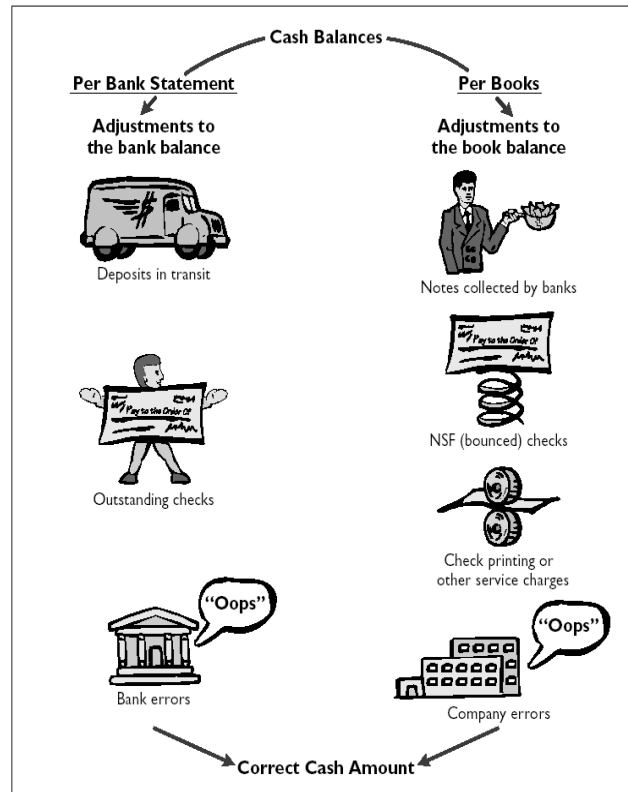
- ◆ A company can safeguard its cash by using a bank as a depository and as a clearing house for checks received and checks written.

WRITING CHECKS

- ◆ A check is a written order signed by the depositor directing the bank to pay a specified sum of money to a designated recipient.
- ◆ Three parties to a check are:
 1. Maker (drawer) issues the check
 2. Bank (payer) on which check is drawn
 3. Payee to whom check is payable

- ◆ Steps in preparing a bank reconciliation:
 1. Determine deposits in transit
 2. Determine outstanding checks
 3. Note any errors discovered
 4. Trace bank memoranda to the records
- ◆ Each reconciling item used in determining the adjusted cash balance per books should be recorded by the depositor.

BANK RECONCILIATION



BANK RECONCILIATION

W. A. LAIRD COMPANY Bank Reconciliation April 30, 2005

Cash balance per bank statement		\$ 15,907.45
Add: Deposits in transit		<u>2,201.40</u>
		18,108.85
Less: Outstanding checks		
No. 453	\$ 3,000.00	
No. 457	1,401.30	
No. 460	<u>1,502.70</u>	<u>5,904.00</u>
		=====
Cash balance per books		\$ 11,589.45
Add: Collection of \$1,000 note receivable plus interest earned		
\$50, less collection fee \$15	\$ 1,035.00	
Error in recording check 443	<u>36.00</u>	<u>1,071.00</u>
		12,660.45
Less: NSF check	425.60	
Bank service charge	<u>30.00</u>	<u>455.60</u>
		=====

ENTRIES FROM BANK RECONCILIATION

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Apr. 30	Cash	1035	
	Miscellaneous Expense	15	
	Notes Receivable		1000
	Interest Revenue		50
	(To record collection of notes receivable by bank)		

Collection of Note Receivable: This entry involves four accounts. Interest of \$50 has not been accrued and the collection fee is charged to Miscellaneous Expense.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Apr. 30	Cash Accounts Payable — Andrea Company (To correct error in recording check No. 443)	36	36

Book Error: An examination of the cash disbursements journal shows that check No. 443 was a payment on account to Andrea Company, a supplier. The check, with a correct amount of \$1,226.00, was recorded at \$1,262.00

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Apr. 30	Accounts Receivable — J. R. Baron Cash (To record NSF check)	425.60	425.60

NSF Check: An NSF check becomes an accounts receivable to the depositor.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Apr. 30	Miscellaneous Expense Cash (To record charge for printing company checks)	30	30

Bank Service Charges: Check printing charges (DM) and other bank service charges (SC) are debited to Miscellaneous Expense because they are usually nominal in amount.

STUDY OBJECTIVE 8: REPORTING CASH

◆ Cash reported on the Balance Sheet includes:

1. Cash on hand
2. Cash in banks
3. Petty cash

- ◆ Cash is listed first in the balance sheet under the title cash and cash equivalents because it is the most liquid asset.

CASH EQUIVALENTS

- ◆ Cash equivalents
 - Are highly liquid investments that can be converted into a specific amount of cash
 - Typically have maturities of 3 months or less when purchasedExamples: Money market funds, bank certificates of deposit, and U.S. Treasury bills and notes

QUESTIONS:

1. The statement that correctly describes the reporting of cash is:
 - 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.
 - d. Restricted cash funds cannot be reported as a current asset.
2. Internal control is used in a business to enhance the accuracy and reliability of its accounting records and to:
 - a. safeguard its assets.
 - b. prevent fraud.
 - c. produce correct financial statements.
 - d. deter employee dishonesty.
3. The Bank Statement for PT Ungu for June 30, 2010, indicates a balance of Rp9.143.110,00. All cash receipts are deposited each evening in a night depository, after banking hours. The accounting records indicate the following summary data for cash receipt and payments for June:

Cash balance as of June 1	Rp3.943.500,00
Total cash receipt for June	28.971.600,00
Total amount od checks issued in June	28.388.850,00

Comparing the bank statement and the accompanying cancelled checks and memoranda with the records reveals the following reconciling items:

- a. The bank had collected for PT Ungu Rp1.030.000,00 on a note left for collection. The face amount of the note was Rp1.000.000,00
- b. A deposit of Rp1.852.210,00 representing receipts of June 30, had been made too late to appear on the bank statement.
- c. Check outstanding totaled Rp5.265.270,00
- d. A check drawn for Rp139.000,00 had been incorrectly charged by the bank as Rp157.000,00.
- e. A check for Rp30.000,00 returned with the statement had been recorded in the company's record as Rp240.000,00. The check was for the payment of an obligation to PT Adi Jaya for the purchase of office supplies on account.
- f. Bank service charges for June amounted to Rp18.200,00.

Instructions:

1. Prepare a bank reconciliation for the June
2. Journalize the entries that should be made by PT Ungu

References:

Weigandt, Jerry J., Donald E. Kieso, Paul D. Kimmel *Accounting Principle*, 8th Ed. New York: John Willey and Sons, Inc. (W)

Reeve, James M, Caarl S. Waren and Jonathan E. Duchac. *Principles of Accounting*. Singapore: Cengage Learning Asia Pte Ltd. (R)