Chapter 8
Sarbanes-Oxley, Internal Control, and Cash

Study Guide

Do You Know…?

Learning Objective 1: Describe the Sarbanes-Oxley Act and its impact on internal controls and financial reporting.
□ The impact of Sarbanes-Oxley on accounting and financial reporting? (See exercises 1–3)

Learning Objective 2: Describe and illustrate the objectives and elements of internal control.
□ The elements of internal controls and factors that contribute to each element? (See exercises 4–6)
□ Why internal controls are not a guarantee to safeguard assets? (See exercises 7–9)

Learning Objective 3: Describe and illustrate the application of internal controls to cash.
□ Controls a business should use over cash receipts? (See exercises 10–12)
□ How to record any differences in cash using a cash short and over account? (See exercises 13–15)
□ Controls a business should use over cash payments? (See exercises 16–18)

Learning Objective 4: Describe the nature of a bank account and its use in controlling cash.
□ If an item will increase or decrease the balance in a bank account and if it is a debit or credit memo? (See exercises 19–21)

Learning Objective 5: Describe and illustrate the use of a bank reconciliation in controlling cash.
□ How to prepare a bank reconciliation and the journal entries based on the reconciliation? (See exercises 22–24)

Learning Objective 6: Describe the accounting for special-purpose cash funds.
□ The journal entries used to record the use of a petty cash fund? (See exercises 25–27)

Learning Objective 7: Describe and illustrate the reporting of cash and cash equivalents in the financial statements.
□ The types of investments used for excess cash and where they are shown on a balance sheet? (See exercises 28–30)
Learning Objective 8: Describe and illustrate the use of the ratio of cash to monthly cash expenses to assess the ability of a company to continue in business.

☐ How to calculate and interpret the ratio of cash to monthly cash expenses? (See exercises 31–33)

Fill-in-the-Blank Equations

1. A company’s checking account balance is a __________ in the bank records.
2. A credit memo entry on the bank statement shows a(n) _________ to the company’s account, while a __________ memo entry on the bank statement shows a decrease in the company’s account.
3. ________________ = Negative cash flow from operations/12
4. Ratio of cash to monthly cash expenses = ________________/monthly cash expenses

Exercises

1. In Poletti Co.’s financial statements, the management makes an assessment of the company’s internal controls. The company produces the assessment every year in its annual financial statements. Who else must make a report on the effectiveness of internal controls?

2. The passing of Sarbanes-Oxley caused companies to strengthen their internal controls. Which of the following relate to internal controls?
   a. Ensuring compliance with local laws and regulations
   b. Processing information accurately
   c. Safeguarding the liabilities

3. Sarbanes-Oxley attempts to do which of the following?
   a. Reduce fraud and theft
   b. Increase bonuses for employees
   c. Restore investor and creditor confidence

4. To which of the five elements of internal controls does each of the following relate?
   a. Investigating missing documents or gaps in transaction numbers
   b. Separating responsibilities for related operations
   c. Personnel policies
5. To which of the five elements of internal controls does each of the following descriptions relate?
   a. Taking necessary actions to minimize risks
   b. Hiring employees with the necessary skills required for the job
   c. Using pronouncements from the FASB to prepare financial statements

6. Which of the following relate to the control procedures a business should possess?
   a. Looking for unusual increases in cash disbursements, such as customer refunds
   b. Using proofs and other security measures
   c. Separating responsibilities for collecting cash payments from customers from recording the cash payments

7. Stop-a-Second’s cash receipt processing has adequate separation of duties among employees. However, the employee who collects the cash, the employee who records the cash receipts, and the employee preparing the deposit ticket for the day may work together to steal cash from the company. Which limitation of internal control is this an example of?

8. The purchasing director of a manufacturer works to find materials at the best prices. Although the director’s responsibilities are adequately separated to avoid theft and fraud, he mistakenly writes down the wrong discount taken by a supplier. To which limitation of internal controls does this relate?

9. Stop-a-Second is preparing its assessment of internal controls for the annual financial statements. The managers verify the employees have sufficient segregation of duties and supervision. However, because the company is quite large, all lower-level employees cannot be supervised at all times to ensure that theft and fraud does not occur. To which limitation of internal controls does this relate?

10. ASC requires that all cashiers receive a cash drawer with exactly $40 before each shift. During each sale, the cashier is prompted to input the type and amount of each payment. The cash register’s screen is usually visible to customers, but the cashier on shift likes to face it toward him due to his bad eyesight. He also has a bad memory, which causes him to forget to give customers their receipts at times. ASC is a small store with many regular customers, so they all trust the cashier is giving them the correct change. Identify any problems in the cash receipts controls that ASC may have.
11. After opening the mail and stamping checks “For Deposit Only,” an employee delivers the cash and money orders to the Cashier’s Department, where he also prepares a bank deposit ticket. After preparing and delivering the bank deposit ticket, the employee also records the cash receipts and posts amounts to the customer accounts. Does the process to record the cash receipts received in the mail have any weaknesses?

12. Since ASC is a small retail business, the supervisor on duty usually collects the cash from the registers and deposits the cash sales on his way home. The next day, he brings the deposit slips to the Accounting Department so the cash sales for the previous day can be recorded. How could ASC strengthen its cash receipts controls?

13. On October 8, 2015, a company’s cash receipts from sales totaled $62,392, while the cash register total for cash sales equaled $62,379. Calculate the shortage or overage and prepare the journal entry to record the cash receipts, sales, and overage or shortage.

14. Williams Supply Co.’s cash receipts from sales totaled $54,470 on August 12, 2015. The cash register total for cash sales for the day was $54,493. How much under or over are the company’s cash receipts for the day? Prepare the journal entry to record the cash receipts, sales, and overage or shortage.

15. On January 23, 2015, a company received $32,629 for the day’s cash sales. The company’s register showed total sales of $45,000, of which 73% were paid for using cash. Calculate the cash shortage or overage. Prepare the journal entry to record the cash receipts, cash sales, and overage or shortage.

16. Titan Coolers creates documents that must be submitted for approval before being recorded in the accounts payable. When approving the document, the employee checks the amounts to the supplier’s invoice, purchase order, and receiving report. Which type of cash payment system does Titan Coolers use?

17. Titan Coolers makes monthly payments for its utilities. To decrease errors, Titan Coolers authorizes an electronic transfer from its bank account to the utility company’s bank account. Which type of cash payment system is the company using?
18. A recent flood has caused Titan Coolers to lose much of its inventory and paperwork. In an attempt to resume business quickly, the company has placed many large orders with multiple suppliers. The accounting department has received the following vouchers and supporting documents for approval:

- Voucher for Invoice No. 201, Ice Mania
- Supplier Invoice No. 375, RediCoolers Inc.
- Receiving Report for Invoice No. 201, IceMania
- Voucher for Invoice No. 202, Big & Cool
- Purchase Order for RediCoolers Inc. (Invoice No. 203)
- Voucher for Invoice No. 375, RediCoolers Inc.

Which documents are missing to approve the vouchers and record the accounts payable ledgers?

19. Determine if each item will appear on the bank statement as a debit or credit memo. Also indicate if the item will increase or decrease the balance of the company’s bank account.

   a. Interest earned on the bank account
   b. Monthly service charge
   c. Correction of a deposit for $410, when the bank originally recorded a deposit of $310

20. RPL Co.’s accountant is preparing the bank reconciliation for the month. The following are shown on the document. Will each be shown as a debit or credit memo to the account? By how much will each item cause the balance of RPL Co.’s bank account to increase or decrease?

   a. Payment to Office Supply Co. for $550
   b. Checks amounting to $642 marked NSF
   c. EC, original payment recorded as $620, corrected to $260

21. Moe’s Mowers received its bank statement for the month of July. The bank statement included the items below. Determine if each item will be a credit or debit memo and if each causes the bank account balance to increase or decrease.

   a. Payments from various customers made by EFT
   b. Proceeds for the company’s construction loan
   c. Service charges for the processing of the loan
22. Moe's Mowers' cash ledger shows a balance of $41,200. The company currently has $9,338 of deposits in transit and $12,000.00 of checks outstanding. Using the bank statement below, prepare the bank statement for the month and prepare the journal entries to update the company's ledgers. Assume all electronic transfers received were to be applied to accounts receivable. The electronic transfer sent was to pay the company's utility bills to Bright Energy.

Charles K. Bank of the Carolinas  
Account number 2237854  
From 8/31/2015 to 9/30/2015

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/1</td>
<td>Deposit</td>
<td>420.75</td>
<td>$49,111.25</td>
</tr>
<tr>
<td>9/5</td>
<td>ACH</td>
<td>2,589.99</td>
<td>$51,701.24</td>
</tr>
<tr>
<td>9/13</td>
<td>Withdrawal</td>
<td>(3,585.13)</td>
<td>$48,116.11</td>
</tr>
<tr>
<td>9/22</td>
<td>Check No. 232</td>
<td>(6,864.12)</td>
<td>$41,251.99</td>
</tr>
<tr>
<td>9/25</td>
<td>Deposit</td>
<td>5,200.00</td>
<td>$46,451.99</td>
</tr>
<tr>
<td>9/25</td>
<td>SC</td>
<td>(55.00)</td>
<td>$46,396.99</td>
</tr>
<tr>
<td>9/30</td>
<td>NSF-Joe Kyuk</td>
<td>(1,750.19)</td>
<td>$44,646.80</td>
</tr>
<tr>
<td>9/30</td>
<td>ACH</td>
<td>(1,828.80)</td>
<td>$42,818.00</td>
</tr>
</tbody>
</table>

Balance 8/31 $48,690.50  
Balance 9/30 $42,818.00
23. Kelby’s Kibbles’ cash ledger shows a balance of $2,570.20. On October 31, 2015, the company made a deposit of $1,320.40 and wrote a check to suppliers for $892.50. With the bank statement shown below, prepare a bank reconciliation for the month of October and the journal entries to adjust Kelby Kibble’s cash ledger. All electronic transfers received should be applied to accounts receivable. The electronic transfers sent should be applied to the company’s outstanding balance with Bright Energy.

Charles K. Bank of the Carolinas
Account number 2236862
From 9/30/2015 to 10/31/2015

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/5</td>
<td>Loan Proceeds</td>
<td>1,860.35</td>
<td>3,399.89</td>
</tr>
<tr>
<td>10/6</td>
<td>SC</td>
<td>(115.00)</td>
<td>3,284.89</td>
</tr>
<tr>
<td>10/12</td>
<td>Deposit</td>
<td>1,350.26</td>
<td>4,635.15</td>
</tr>
<tr>
<td>10/16</td>
<td>Check No. 652</td>
<td>(1,822.70)</td>
<td>2,812.45</td>
</tr>
<tr>
<td>10/24</td>
<td>Deposit</td>
<td>1,075.20</td>
<td>3,887.65</td>
</tr>
<tr>
<td>10/25</td>
<td>ACH</td>
<td>435.20</td>
<td>4,322.85</td>
</tr>
<tr>
<td>10/29</td>
<td>NSF-Jim Torti</td>
<td>(199.70)</td>
<td>4,123.15</td>
</tr>
<tr>
<td>10/30</td>
<td>ACH</td>
<td>(800.60)</td>
<td>3,322.55</td>
</tr>
<tr>
<td>10/31</td>
<td>NSF-Dan Snead</td>
<td>(47.30)</td>
<td>3,275.25</td>
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</tbody>
</table>

Balance 9/30 $1,539.54
Balance 10/31 $3,275.25
24. Tiger Honey’s cash ledger shows a balance of $2,870.20, which includes a deposit in transit of $890.60 and outstanding checks totaling $500.75. Prepare a bank reconciliation for the company with the given bank statement for the month of August. Record the journal entries to update the company’s cash ledger to the adjusted balance. All electronic transfers received should be applied to accounts receivable while electronic transfers sent should be applied to the company’s outstanding balance with Busy Bees.

Charles K. Bank of the Carolinas

Account number 215350

From 7/31/2015 to 8/31/2015

Balance 7/31 $2,397.72

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>8/2</td>
<td>Deposit</td>
<td>320.25</td>
</tr>
<tr>
<td>8/5</td>
<td>NSF-Dan Snead</td>
<td>(46.49)</td>
</tr>
<tr>
<td>8/8</td>
<td>ACH</td>
<td>300.15</td>
</tr>
<tr>
<td>8/12</td>
<td>Check No. 545</td>
<td>(37.50)</td>
</tr>
<tr>
<td>8/15</td>
<td>Notes Receivable</td>
<td>300.00</td>
</tr>
<tr>
<td>8/20</td>
<td>ACH</td>
<td>(312.50)</td>
</tr>
<tr>
<td>8/24</td>
<td>Check No. 546</td>
<td>(200.12)</td>
</tr>
<tr>
<td>8/28</td>
<td>NSF-Jill Jackson</td>
<td>(124.50)</td>
</tr>
<tr>
<td>8/31</td>
<td>SC</td>
<td>(15.00)</td>
</tr>
<tr>
<td>8/31</td>
<td>ACH</td>
<td>350.00</td>
</tr>
</tbody>
</table>

Balance 8/31 $2,932.01

25. On March 1, 2015, Tiger’s Honey creates a $750 petty cash fund to pay for small expenses. At the end of the month, the petty cash receipts included payments for: office supplies, $225; plumbing repair (record as a maintenance expense), $190; and shipping expenses, $60. The petty cash fund had $265 on hand at the end of the month. Prepare the journal entries to establish the fund and replenish the fund at the end of the month, recording any shortage or overage in the account.

26. Lily’s Doodles creates a petty cash fund of $300 at the beginning of April. During the month, the company used the petty cash fund to pay for the following: office supplies, $80; miscellaneous administrative expenses, $55; and delivery fees, $24. The company had $146 of petty cash on hand at the end of the month. Prepare the journal entries to establish the fund and replenish the fund at the end of the month, recording any cash short or over.
27. At the beginning of June, Lily’s Doodles creates a petty cash fund of $400. On June 30, 2015, the remaining amount of cash in the petty cash fund is $95. The company replenished the fund based on the following receipts from the petty cash fund: office supplies, $175; store supplies, $65; and delivery fees, $55. Record the journal entry to establish the fund and replenish the fund at the end of the month. Any missing funds should be recorded in the cash short and over account.

28. Tiny Treats has a cash balance of $3,700 at the beginning of August 2015. To earn interest on excess cash, the company invests $400 in U.S. Treasury bills and $900 in commercial paper. How much excess cash is invested in cash equivalents? Prepare the portion of the balance sheet that shows how these will be reported.

29. On December 31, 2015, Tiny Treats has a balance of $890 in its bank account. The company also has $500 invested in U.S. Treasury bills and long-term investments that total $1,560. How much in cash and cash equivalents will the company’s balance sheet present?

30. Tiny Treats’ bank statement on September 30, 2015, has a balance of $1,475. The only discrepancy between the bank statement and cash ledger is an outstanding check for $90. The company also has the following investments: U.S. Treasury bills, $590; commercial paper, $320; and long-term notes receivable, $1,300. Prepare the portion of the company’s quarterly balance sheet that presents the cash and cash equivalents.

31. Using the following information, calculate MAF Co.’s ratio of cash to monthly cash expenses and interpret the results of the ratio. Round answers to two decimal places.

<table>
<thead>
<tr>
<th>For the year ended December 31, 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents at year-end</td>
</tr>
<tr>
<td>Cash flow from operations</td>
</tr>
</tbody>
</table>

32. Using the following information, calculate MAF Co.’s ratio of cash to monthly cash expenses for 2015 and 2016. Interpret the results of the ratio. Round answers to two decimal places.

<table>
<thead>
<tr>
<th>For the years ended</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2016</td>
</tr>
<tr>
<td>Cash and cash equivalents at year-end</td>
</tr>
<tr>
<td>Cash flow from operations</td>
</tr>
</tbody>
</table>
33. Using the following information, calculate MAF Co.’s ratio of cash to monthly cash expenses for 2015 and 2016. Interpret the results of the ratio. Round answers to two decimal places.

<table>
<thead>
<tr>
<th>For the years ended</th>
<th>December 31, 2016</th>
<th>December 31, 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents at year-end</td>
<td>$ 20,470</td>
<td>$ 15,380</td>
</tr>
<tr>
<td>Cash flow from operations</td>
<td>(26,300)</td>
<td>(25,200)</td>
</tr>
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</table>