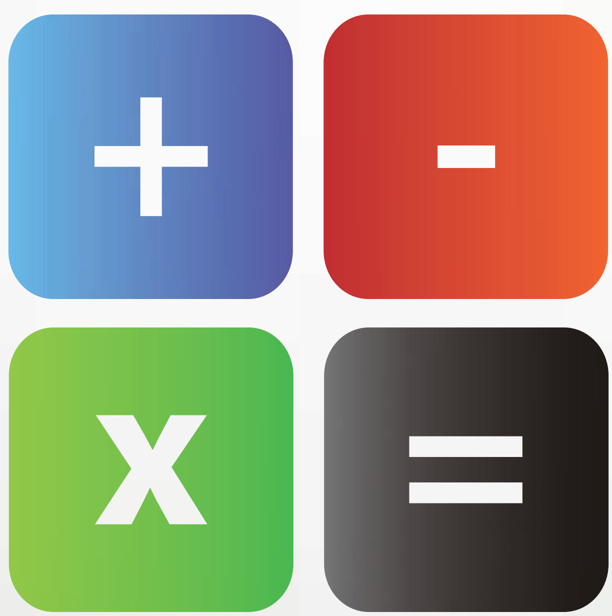
GLOBAL EDITION

Horngren's Accounting

TENTH EDITION

Nobles • Mattison • Matsumura



ALWAYS LEARNING

PEARSON

HORNGREN'S
ACCOUNTING

TENTH EDITION

Global Edition

Tracie Nobles
Texas State University–San Marcos

Brenda Mattison
Tri-County Technical College

Ella Mae Matsumura
University of Wisconsin–Madison

PEARSON

Boston Columbus Indianapolis New York San Francisco Upper Saddle River
Amsterdam Cape Town Dubai London Madrid Milan Munich Paris Montréal Toronto
Delhi Mexico City São Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo

> Try It!

For each of the following items, determine whether the item would be:

a. added to the bank balance
b. subtracted from the bank balance
c. added to the book balance
d. subtracted from the book balance

9. Interest revenue earned
10. NSF check
11. Deposit in transit
12. Service charge
13. Outstanding check

Check your answers at the end of the chapter.

For more practice, see Short Exercises S8-6 through S8-9. MyAccountingLab

HOW CAN THE CASH RATIO BE USED TO EVALUATE BUSINESS PERFORMANCE?

Learning Objective 6
Use the cash ratio to evaluate business performance

Cash is an important part of every business. Without an adequate supply of available cash, businesses cannot continue to operate. Businesses, therefore, monitor cash very carefully. One measure that can be used to measure a company's liquidity is the cash ratio. The **cash ratio** helps to determine a company's ability to meet its short-term obligations. It is calculated as follows:

$$\text{Cash ratio} = (\text{Cash} + \text{Cash equivalents}) \,/\, \text{Total current liabilities}$$

Cash Ratio
A measure of a company's ability to pay current liabilities from cash and cash equivalents: (Cash + Cash equivalents) / Total current liabilities.

Cash Equivalent
A highly liquid investment that can be converted into cash in three months or less.

Notice that the cash ratio includes cash and cash equivalents. **Cash equivalents** are highly liquid investments that can be converted into cash in three months or less. Examples of cash equivalents are money-market accounts and investments in U.S. government securities.

Returning to **Green Mountain Coffee Roasters, Inc.**, let's evaluate the company's liquidity using the cash ratio. Green Mountain's cash and cash equivalents and total current liabilities can be found on the balance sheet located in Appendix A and are presented below (shown in thousands):

	September 24, 2011	September 25, 2010
Cash and cash equivalents	$ 12,989	$ 4,401
Total current liabilities	471,374	238,055

Green Mountain's cash ratio as of September 24, 2011 follows:

Cash ratio = $12,989 / $471,374 = 0.028*

* rounded

In comparison, the cash ratio as of September 25, 2010 was:

Cash ratio = $4,401 / $238,055 = 0.018*

* rounded

The cash ratio has increased slightly from 2010 to 2011 due to an increase in available cash and cash equivalents. This ratio is the most conservative valuation of liquidity because it looks at only cash and cash equivalents, leaving out other current assets such as merchandise inventory and accounts receivable. Notice that for both years, the cash ratio was below 1.0. Having a cash ratio below 1.0 is a good thing. A cash ratio above 1.0 might signify that the company has an unnecessarily large amount of cash supply. This cash could be used to generate higher profits or be taken out for owners' withdrawals. However, a very low ratio doesn't send a strong message to investors and creditors that the company has the ability to repay its short-term debt.

> Try It!

14. The Scott Sun & Shade Company had the following financial data for the year ended December 31, 2015:

Cash and cash equivalents	$ 60,000
Total current liabilities	75,000

What is the cash ratio as of December 31, 2015, for Scott Sun & Shade?

Check your answer at the end of the chapter.

For more practice, see Short Exercise S8-10. MyAccountingLab

REVIEW

> Things You Should Know

1. What is internal control and how can it be used to protect a company's assets?

- Internal control is the organizational plan and all the related measures designed to safeguard assets, encourage employees to follow company policies, promote operational efficiency, and ensure accurate and reliable accounting records.
- The Sarbanes-Oxley Act was passed by Congress to revamp corporate governance in the United States.
- Internal control includes five components: control procedures, risk assessment, information system, monitoring of controls, and environment.

2. What are the internal control procedures with respect to cash receipts?

- A point-of-sale terminal provides control over cash receipts over the counter.
- Companies control cash by mail by ensuring appropriate separation of duties when handling cash and recording the transaction.

3. What are the internal control procedures with respect to cash payments?

- Good separation of duties between operations of the business and writing checks for cash payments should exist.
- A voucher system can be used to control cash payments

4. How can a petty cash fund be used for internal control purposes?

- A petty cash fund allows a business to keep cash on hand to pay for small miscellaneous items such as postage, office supplies, and taxi fare.
- When the petty cash fund is opened, the company records a debit to Petty Cash and a credit to Cash.
- The fund is replenished by debiting the associated asset and expense accounts and crediting Cash.
- Discrepancies in petty cash funds are either debited or credited to the Cash Short & Over account.

5. How can the bank account be used as a control device?

- Bank accounts provide established practices that safeguard a business's money. These controls include use of signature cards, deposit tickets, checks, bank statements, and electronic funds transfers.
- A bank reconciliation can also be used as a form of internal control. The bank reconciliation compares and explains the difference between cash on the company's books and cash according to the bank's records on a specific date.
- After the bank reconciliation has been prepared, journal entries must be completed for all items on the book side of the bank reconciliation.

6. How can the cash ratio be used to evaluate business performance?

- The cash ratio measures a company's ability to pay its current liabilities from cash and cash equivalents.
- Cash ratio = (Cash + Cash equivalents) / Total current liabilities.

> Summary Problem 8-1

Misler Company established a $300 petty cash fund on January 12, 2015. Karen Misler (KM) is the fund custodian. At the end of the month, the petty cash fund contains the following:

a. Cash: $163

b. Petty cash tickets, as follows:

No.	Amount	Issued to	Signed by	Account Debited
44	$14	B. Jarvis	B. Jarvis and KM	Office Supplies
45	39	S. Bell	S. Bell	Delivery Expense
47	43	R. Tate	R. Tate and KM	—
48	33	L. Blair	L. Blair and KM	Travel Expense

Requirements

1. Identify three internal control weaknesses revealed in the given data.
2. Journalize the following transactions:
   - **a.** Establishment of the petty cash fund on January 12, 2015.
   - **b.** Replenishment of the fund on January 31, 2015. Assume petty cash ticket no. 47 was issued for the purchase of office supplies.
3. What is the balance in the Petty Cash account immediately before replenishment? Immediately after replenishment?

> Solution

Requirement 1

The three internal control weaknesses are as follows:

1. Petty cash ticket no. 46 is missing. There is no indication of what happened to this ticket. The company should investigate.
2. The petty cash custodian (KM) did not sign petty cash ticket no. 45. This omission may have been an oversight on her part. However, it raises the question of whether she authorized the payment. Both the fund custodian and the recipient of the cash should sign the petty cash ticket.
3. Petty cash ticket no. 47 does not indicate which account to debit on the actual ticket. If Tate or Karen Misler do not remember where the $43 went, then the accountant will not know what account should be debited.

Requirement 2

Petty cash journal entries:

a. Entry to establish the petty cash fund:

Date	Accounts and Explanation	Debit	Credit
Jan. 12	Petty Cash	300	
	Cash		300
	To open the petty cash fund.		

b. Entry to replenish the fund:

Date	Accounts and Explanation	Debit	Credit
Jan. 31	Office Supplies	57	
	Delivery Expense	39	
	Travel Expense	33	
	Cash Short & Over	8	
	Cash		137
	To replenish the petty cash fund.		

Requirement 3

The balance in the Petty Cash account is *always* its imprest balance, in this case $300.

> Summary Problem 8-2

The Cash account of Baylor Associates at February 28, 2015, follows.

Cash

Beg. Bal.	3,995	400	Feb. 3
Feb. 6	800	3,100	Feb. 12
Feb. 15	1,800	1,100	Feb. 19
Feb. 23	1,100	500	Feb. 25
Feb. 28	2,400	900	Feb. 27
End. Bal.	4,095		

Baylor Associates received the following bank statement on February 28, 2015:

BANK OF TOMORROW
123 PETER PAN RD, KISSIMMEE, FL 34747

BANK STATEMENT

Baylor Associates
14 W Gadsden St
Pensacola, FL 32501

CHECKING ACCOUNT 136–213734
FEBRUARY 28, 2015

BEGINNING BALANCE	TOTAL DEPOSITS	TOTAL WITHDRAWALS	SERVICE CHARGES	ENDING BALANCE
$3,995	4,715	5,630	10	$3,070

TRANSACTIONS

DEPOSITS	DATE	AMOUNT
Deposit	02/07	800
Deposit	02/15	1,800
EFT—Collection of note	02/17	1,000
Deposit	02/24	1,100
Interest	02/28	15

CHARGES	DATE	AMOUNT
Service Charge	02/28	10

CHECKS

Number	Amount	Number	Amount	Number	Amount
102	400	103	1,100		
101	3,100				

OTHER DEDUCTIONS	DATE	AMOUNT
EFT—EZ Rent	02/01	330
NSF Check	02/13	700

Additional data:

Baylor deposits all cash receipts in the bank and makes all payments by check.

Requirements

1. Prepare the bank reconciliation of Baylor Associates at February 28, 2015.
2. Journalize the entries based on the bank reconciliation.