Chapter 1 Introduction

LEARNING OBJECTIVES

By the end of this chapter, you will be able to:

- Understand the concept of international accounting
- Describe basic accounting elements
- Understand the accounting equation
- Explain main accounting concepts and principles
- Outline International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS)
- Outline Chinese Accounting Standards (CAS)

KEY POINTS OF THIS CHAPTER

- International accounting includes a broad number of territories, both geographically and topically. It can be defined at three levels.
- The basic accounting elements include assets, liabilities, equity, revenues, expenses and profit or loss.
- The relationship between accounting elements can be expressed in a simple mathematical form known as accounting equation.
- The concepts and principles in this chapter include accounting entity principle, accounting period principle, monetary unit principle, going concern principle, cost principle, conservatism principle and full disclosure principle.

WHAT IS INTERNATIONAL ACCOUNTING?

Accounting is the "language of business," which is to provide reliable and relevant financial information for decision makers inside or outside the business, including managers, shareholders and other stakeholders. Accounting information can help users understand a business entity's past performance, current financial position, and future prospect. The accounting process through which information is provided to users is as follows:

1. Identify users.
2. Assess users' information needs.
3. Design the accounting information system to meet users' needs.
4. Record economic data about business activities and events.
5. Prepare accounting reports for users.

The provision of accounting information for users within the business entity is referred to as managerial accounting. The preparation and presentation of financial reports for external users relate to financial accounting.

Most accounting students are familiar with financial accounting and managerial accounting, but many may only have a vague idea of international accounting. International accounting includes a broad number of territories, both geographically and topically. It can be defined at three levels. The first level is supranational accounting, which encompasses standards, guidelines, and rules of accounting, auditing, and taxation issued by supranational organizations, such as the United Nations. The second level is the company level. At this level, international accounting can be seen as the study of standards, guidelines, and practices that a company follows related to its international business activities and foreign operations. At the third level, international accounting can be viewed as the study of standards, guidelines, and rules of accounting, auditing, and taxation that exist within one country as well as comparison of those items across countries.

This textbook is designed to provide an overview of the broadly defined area of international accounting for Chinese students according to accounting elements division and focus on the comparison of standards, regulations and rules of accounting issues between IAS and CAS.

ACCOUNTING ELEMENTS AND ACCOUNTING EQUATION

Accounting Elements

Since accounting provides information about business activities and events, the information can be classified according to economic characteristics of these business activities and events. These categories of accounting information are accounting elements. Typical accounting elements are assets, liabilities, equity, revenues, expenses and profit or loss.

Assets

Assets are the resources which arise from past transactions or events and are owned or controlled by the company. These resources are expected to bring economic benefits to the company.

Assets have the following features:

- Assets are in nature economic resources.
- Assets were formed in the past.
- Assets are able to bring economic benefits, which may include direct or indirect inflows of cash or cash equivalents.
- Assets must be owned or controlled by the company.
- Assets can be measured by money.

Assets can be classified into current assets and non-current assets. Current assets are economic resources that would be liquidated within one year or one operating cycle (whichever is longer), such as cash, accounts receivable, supplies, inventories and short-term investment. Non-current assets consist of long-term economic resources that are held for operational purposes, such as plant, property and equipment, long-term investment, intangible assets, etc.

Liabilities

Liabilities are the duties arising from past transactions or events. The fulfillment of the duties will cause the outflow of economic benefits.

Liabilities have the following features:

- Liabilities are the duties caused by past or current accounting events.
- Liabilities will lead to future sacrifice of economic benefits.
- Liabilities can be measured by money, or can be reasonably estimated by money.
- Liabilities can be paid off by transferring assets, providing services, or borrowing new liabilities.

Liabilities can be classified into current liabilities and non-current liabilities. Current liabilities are the debts that come due within one year or one operating cycle (whichever is longer), including accounts payable, notes payable, taxes payable, portions of long-term debt due within one year or one operating cycle, etc. Non-current liabilities are the debts whose maturity date is longer than one year, such as long-term notes, mortgages and bonds payable.

Equity

Equity is the residual interest in the assets of a company after deducting all its liabilities.

Equity has the following features:

- Equity is a duty rather than a right for a company.
- Only in an abstract and holistic way is equity related to assets of a company.

Typical equity includes paid-in capital, retained earnings, capital reserve and surplus reserve.

Revenues

Revenues refer to the inflows of economic benefits which are caused by selling goods, providing services, and other economic activities.

Revenues have the following features:

- Revenues are an achievement of a company within a certain period.
- Revenues may lead to an increase in assets, a decrease in liabilities, or both.
- Increase in revenues will increase equity.

Expenses

Expenses refer to the outflows of economic benefits as a result of purchasing goods, receiving services, and other economic activities.

Expenses have the following features:

- Expenses can be matched with relevant revenues.
- Expenses can be divided into cost of production and period expenses.
- Expenses may cause a decrease in assets, an increase in liabilities, or both.
- Increase in expenses will decrease equity.

Profit or loss

Profit or loss is the operating result of a company over an accounting period, which is the result of sales/revenues minus expenses.

Accounting Equation

The relationship between accounting elements can be expressed in a simple mathematical form known as accounting equation:

Assets = Liabilities + Equity

Profit

+Revenues **-Expenses**

The equation represents the relationship between assets, liabilities and equity of a company. It is the basis for setting up accounts, double entry bookkeeping, and preparing financial statements. For each transaction, the total debits equal to total credits. The effect of any transaction on the accounting equation may be indicated by increasing or decreasing a specific asset, liability or equity element. Each transaction has either equal effects on both sides of the equation or counteracting effects on one side of the equation, so that the equation will remain in balance. The accounting equation is valid at all time over the life of the business.

CONCEPTS AND PRINCIPLES

In the previous section, accounting elements and equation have been outlined. Now the underlying principles are presented.

Accounting entity principle

The accounting entity principle states that the recorded activities of a business entity will be separated from the recorded activities of its owner. An accounting entity can be either a business or subdivision of a business that engages in economic activities with economic resources that must be accounted, and is separate from the personal dealings of its owners.

Accounting period principle

The accounting period principle states that the life of a business can be divided into artificial periods and that reports covering those periods can be prepared for the business. All entities report at least annually. Listed companies report at least semiannually to shareholders.

Monetary unit principle

The monetary unit principle of accounting states that all the transactions must be recorded in the form of currency. In other words, a business only records those transactions that can be expressed in monetary terms. And the information of these transactions that cannot be expressed in monetary terms may not be recorded in the financial statements, even though it may be important to users of the financial statements.

Going concern principle

The going concern principle states that a business will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. Management must make an assessment of the validity of the going concern principle when preparing financial statements under the requirement of accounting standards. It allows the company to defer some of its prepaid expenses until future accounting periods.

Cost principle

The cost principle states that all assets are initially recorded in the accounts at their purchase price or cost. Because of this principle, the value of the recorded assets is not adjusted upward for inflation, neither for time value. The cost principle is often criticized as being irrelevant. Critics argue that market value would be more useful to make financial decisions. Proponents of the cost principle say that cost is the best measure as it can be verified easily from transactions between two parties, whereas market value is often subjective.

Conservatism principle

If there are two acceptable alternatives for reporting an item, conservatism directs the accountant to choose the alternative that will result in less net income or less asset amount. The basic accounting principle of conservatism leads accountants to anticipate or disclose more losses, but it does not allow a similar action for gains.

Full disclosure principle

The full disclosure principle states that the business entity's financial statements should contain all information that would affect users' understanding of financial statements. The interpretation of this principle is highly judgmental since the amount of information that can be provided is potentially massive. To reduce the amount of disclosure, it only discloses the information about events that are likely to have a material impact on the financial position and financial results of the company. If an important item cannot be reported directly in the financial statements, it should be discussed in the notes to the statements.

I INTRODUCTION TO INTERNATIONAL ACCOUNTING STANDARDS (IAS)

The original international accounting standards setter, the International Accounting Standards Committee (IASC), was established in 1973 by an agreement of the leading professional accounting bodies in 10 countries with the broad objective of formulating international accounting standards. IASC issued 41 International Accounting Standards during the period from 1973 to 2001. Twelve of these standards have been superseded or withdrawn. Most of the remaining standards have been revised one or more times. On April 1, 2001, the newly created International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting international accounting standards. The

IASB has continued to develop standards which were then called International Financial Reporting Standards (IFRS). The formation of the IASB in 2001 with a change in focus from harmonization of accounting across the European Union to convergence of global accounting standards setting, manifested the beginning of a new era in international financial reporting. Since 2001, the IASB has issued 15 IFRSs and 41 IASs.

I INTRODUCTION TO CHINESE ACCOUNTING STANDARDS (CAS)

In Anglo-American countries, setting accounting standards is the responsibility of accounting societies or independent bodies created for that purpose, whereas in China, it is the responsibility of the Ministry of Finance (MOF). In 1992, the MOF promulgated the first accounting standard, the Basic Standard of Accounting for Business Enterprises (similar to a conceptual framework), which was a landmark in Chinese accounting reforms. It has then been superseded by 16 Chinese Accounting Standards up to the end of 2001. The MOF issued 22 CASs again in 2006. So far, the 42 CASs make up a relatively complete Chinese accounting standard system. Since China is the member country of IFAC, the MOF follows the international accounting practice in setting Chinese standards, which implies the convergence of CAS to IAS/IFRS. However, there are still many differences between IAS/IFRS and CAS. These differences will be specifically discussed in the following chapters.

EXERCISES

Please classify the following items into appropriate accounting elements and complete the following table.

notes payable; bank deposit; sales; advertising expense; plant, property and equipment; depreciation; manufacturing cost; accounts receivable; prepaid insurance; share capital; interest revenue; earnings before interest and tax

Accounting Elements	Items
Assets	
Liabilities	
Equity	

(to be continued)

(continued)

Revenues	
Expenses	
Profit or loss	

DISCUSSION QUESTIONS

1. What is international accounting?
2. What are basic accounting elements? Please explain each in details.
3. What is the possible effect of a transaction on accounting equation?
4. Please explain the accounting concepts and principles that are presented in this chapter.

KEY TERMS OF THIS CHAPTER

- **Assets:** Resources which arise from past transactions or events and which are owned or controlled by the company.
- **Liabilities:** Duties which arise from past transactions or events.
- **Equity:** The residual interest in the assets of a company after deducting all its liabilities.
- **Revenues:** Inflows of economic benefits which are caused by selling goods, providing services, and other economic activities.
- **Expenses:** Outflows of economic benefits as a result of purchasing goods, receiving services, and other economic activities.
- **Profit or loss:** Operating result of a company over an accounting period, which is the result of revenues minus expenses.
- **Monetary unit principle:** The principle requires that only transactions that can be expressed in monetary terms are included in the accounting records.
- **Accounting entity principle:** The concept states that the recorded activities of a business entity will be separated from the recorded activities of its owner.
- **Accounting period concept:** The concept states that the life of a business can be divided into artificial periods and that reports covering those periods can be prepared for the business.
- **Going concern principle:** The principle states that a business will remain in operation for the foreseeable future.

- ➔ **Cost principle:** The principle states that all assets are initially recorded in the accounts at their purchase price or cost.
- ➔ **Conservatism principle:** The principle states that when preparing the financial statements, the accountant should use the more conservative or prudent estimate if the value of an asset or the future cash flows are uncertain.
- ➔ **Full disclosure principle:** The principle requires that the business entity's financial statements should contain all information that would affect users' understanding of financial statements.

Chapter 2
Cash

LEARNING OBJECTIVES

By the end of this chapter, you will be able to:

- Describe the nature of cash and the importance of internal control over cash.
- Use a petty cash fund to account for cash transactions.
- Describe the importance of a bank account and understand why it is useful for good control over cash.
- Identify the differences between bank statement and book record and know how to prepare bank reconciliation.

KEY POINTS OF THIS CHAPTER

- Cash includes coins, currency (paper money), checks, money orders, and money on deposit that is available for unrestricted withdrawal from banks and other financial institutions. Because money can be transferred easily, businesses should design and apply control procedures to safeguard cash and strictly monitor the authorization of cash transactions.
- Companies operate a petty cash fund to pay relatively small amounts of cash. They must first deposit cash in the fund, then make payments from the fund, and replenish the fund when the cash in the fund drops to a minimum level.
- Usually, bank statements summarizing all of the transactions are sent to the depositor every month. The bank statement enables a business entity to compare the cash transactions recorded in the accounting records with those recorded by the bank.
- To maintain a good internal control over cash, it is necessary to reconcile the balance per books and balance per bank to their adjusted balances.

ACCOUNTING FOR CURRENT ASSETS

In accounting, an asset is an economic resource owned or controlled by a business entity. Assets can be tangible such as vehicles, cash and buildings; assets can also be intangible such as goodwill and patents. In a company's Statement of Financial Position, assets are normally classified into Current Assets and Non-Current Assets. Current assets are those assets that can either be converted into cash or used to pay current liabilities within 12 months. Typical current assets include cash and cash equivalents, accounts receivable, stock, short-term investments, prepayments, etc. In this textbook, we will discuss the accounting for current assets from Chapter 2 to Chapter 4. Cash, being the most liquid current asset, will be introduced in this chapter.

NATURE OF CASH

In accounting, cash includes coins, paper money, checks, money orders, and money on deposit with banks. The following rule can be used to judge whether a certain item should come within the classification of cash: **Any medium of exchange which a bank will accept for deposit is included in cash**. For example, checks and money orders are accepted by banks for deposit and are considered cash.

Compared with other assets, cash is obviously more susceptible to theft; inside a company, cash is the most vulnerable asset to employees' improper use and there are even more risks outside a company. Therefore companies must design good control procedures and apply them properly to control transactions involving cash and safeguard cash in hand.

Management Responsibilities Relating to Cash

Efficient cash management includes measures that will:

1. Prevent in advance any losses of cash from fraud or theft.
2. Accurately account for cash receipts, cash payments, and cash balances.
3. Maintain a reasonable amount of cash to meet for the need of routine tasks and for emergencies.
4. Prevent large balance of cash from being kept idle in bank accounts, because these assets produce no more revenue than just small amount of interests.

To achieve the above objectives, especially the first two, there are some basic requirements for internal control over cash that must be followed. First of all, the function of recording cash transactions must be separated from the function of custody of cash. Second, the recording responsibilities should be separately born by employees, so that the work done by one employee is verified by another employee. Fraud will be discouraged by these control procedures, because it usually takes more than one employee to conceal an irregularity. Larger companies will find it easy to achieve successful internal control over cash, because more employees are available for responsibility separation.

Major Steps of Internal Control over Cash

Major steps in establishing internal control over cash are as follows:

1. Separate the function of handling cash from the recording of accounting records. Employees who handle cash should not have access to the accounting records, and accounting personnel should not have access to cash.
2. Establish separate and clear-cut routines to be followed in the process of handling cash receipts, making cash payments, and recording cash transactions.
3. It is best to require that all cash receipts be deposited daily in the bank and that all significant cash payments be made by check. Cash payments should not be made directly from cash receipts on hand.
4. Require that the validity and amount of every expenditure be verified before payment is made.
5. Separate the function of approving expenditures from the function of signing checks.

Petty Cash Fund

As is listed above, significant cash payments should be made in check or through bank accounts so that good internal control over cash is maintained; however, using checks to pay small amount is often both impractical and a nuisance. For example, it is not possible to pay checks for taxi fare or stamp. Businesses therefore often use a petty cash fund to pay for relatively small amount of money, and this system could help maintain a satisfactory control over cash. There are three steps involved in this system: 1) establish the petty cash fund; 2) make disbursements from the fund; 3) replenish the fund.

Establish the petty cash fund. To create a petty cash fund, a check is written for a round amount such as $100, or $200, or whatever stipulated amount that will cover the small expenditures to be paid in cash for a period of two or three weeks. This check is cashed and the money is kept on hand in a petty cash box or drawer in the office. Suppose that a petty cash fund of $200 is established on June 1, the journal entry for the issuance of the check is:

June	1	Petty Cash	200	
		Cash		200

Make disbursement from the fund. To make cash payments out of the petty cash fund, the personnel who deals with the fund is required to fill out a petty cash voucher for each expenditure; the voucher will show the amount paid, the purpose of the expenditure, the date, and the signature of the person who receives the money. The total amount of the cash and/or vouchers in the petty cash box should therefore always equal to the value of the fund when it was first established. The company does not have to make any accounting entry to record a payment from petty cash. Instead, journal entry is made every time when the fund is replenished.

Replenish the petty cash fund. As the day goes by, the money in the petty cash fund will sooner or later drop to a minimum level, and the company needs to replenish the fund. Continue from the above illustration where $200 petty cash fund was established: Assume that payments totalling $183.25 were made from the fund during the next two weeks. Since the $200 originally deposited in the fund is nearly used up, the fund should be replenished. Replenishing a petty cash fund means to replace the money that has been spent, i.e. refilling the fund to its original amount. To do this, a check is drawn on June 15 payable to petty cash for the exact amount of the expenditures that have been spent, i.e. $183.25 in this case. This check is cashed and the money is placed in the petty cash box. Before making journal entries, the accountant first have to inspect the petty cash vouchers to decide what kind of expenses were spent, then he or she could record the issuance of the check by debiting each expense account as follows:

June	15	Postage Expense	81.75	
		Office Supplies Expense	67.90	
		Miscellaneous Expense	33.60	
		Cash		183.25

Please note that the Expense accounts are debited when and only when the fund is replenished. The Petty Cash account is debited when and only when the fund is first established. There will ordinarily be no further entries in the Petty Cash account after the fund is established, unless the fund is discontinued or a decision is made to change its size from the original amount.

BANK ACCOUNTS

Using a bank account is very important to good internal control over cash. The use of a bank account could minimize the amount of money that a company must keep on hand. Many businesses nowadays have more than one bank account. National supermarket retailers like Tesco and Vanguard may have several regional bank accounts in different areas of the country, for efficiency of operations and better control. Some large companies have thousands of employees and therefore may need a separate payroll bank account in addition to the general bank accounts. Furthermore, a company may keep quite a few bank accounts at the same time in order to have more than one source of short-term loans when needed.

Making Bank Deposits

When you open a current account at a bank, the bank will ask you to sign a signature card. The bank will later use the signature card to verify the signature on checks that are submitted for payment. Also, when an account is opened, a corresponding identification number is also assigned for the account. Each account has a unique account number. Current account is also referred to as checking account. Money in a checking account is very liquid, and can be withdrawn using checks, ATM machines and electronic debits, usually without any limitation.

Usually it is the head cashier who makes deposits into the bank account. When a deposit is made, the bank will record the deposit on a deposit slip (ticket). This ticket will be produced in duplicate. The bank keeps the original and the depositor keeps the duplicate, which is machine-stamped by the bank to establish its authenticity.

Writing Checks

A check is a written document signed by the depositor, ordering the bank to pay a sum of money to an individual or entity. There are three parties to a check: the drawer (maker), the bank (payer) and the payee. The drawer is the person who issues the check by signing it, ordering the bank to pay a certain amount of money to the payee. The payee is the party to whom payment is to be made.

As shown in Figure 2-1, John Smith is the payee, Barclays is the bank and UWC Financial Services Ltd. is the drawer. By issuing this check, UWC orders its bank, Barclays, to pay John Smith £1,100.

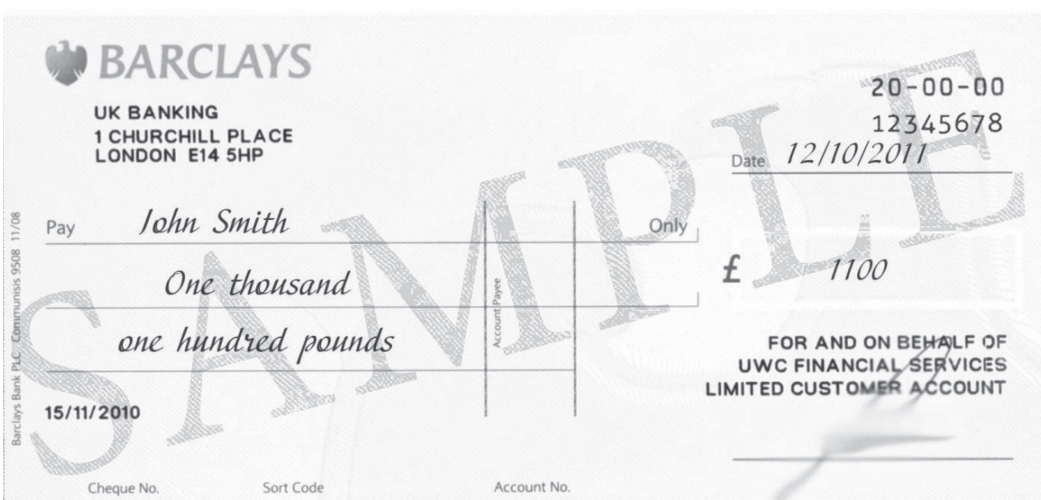

Figure 2-1

Sometimes, the maker issues a check and deducts the relevant amount from his cash book, but the payee does not present the check to the bank for payment until quite some time later. Such a situation will make the balance of the bank account not equal to the balance in the depositor's accounting records. Some other reasons described in the next sections will also cause this difference. To avoid the discrepancies accumulating in the long term, the bank will send bank statements to the depositor regularly, showing the balance of the account at the beginning of the period, the deposits, the check paid, any other debits and credits during the period, and the new balance at the end of the period. If you compare the balance of each bank statement with that of the depositor's accounting book, most probably you will find that the figures do not match. Therefore, companies must make regular bank reconciliation to find out the reasons for the discrepancies.

BANK RECONCILIATION

Using a bank account facilitates the control of cash because it creates a double record of all bank transactions — one by the depositor and the other by the bank. Even though there are records at both ends, we will still inevitably have differences between our records and the bank's for the following types of reasons:

1. Time lags that cause one party to record the transaction in a different period from the other party.
   i. On a certain date, i.e. the period end, there might be some checks which a company received and presented to the bank, but which have not yet been "cleared" and added to the company's bank account. So although the company's own records show that some cash has been received and added in the cash book accordingly, it has not actually yet been acknowledged by the bank — although it will be acknowledged soon once the check has been cleared.
   ii. Similarly, a business might have made some payments by check, and accordingly reduced the balance in the business cash book, but the person who receives the check might not present the check to the bank for a while. Even when the check is presented to the bank, it still takes a day or two for the bank to clear the check and deduct the amount from the business' bank account.
2. Errors by either party (the bank or the depositor) in recording transactions.
3. Cash receipts or payments directly through the bank and therefore unknown to the depositor until a bank statement is received. Examples are bank charges or bank interest. The depositor will not be aware of these transactions before they obtain the bank statements.

For internal control purposes, i.e. trying to protect the business' fund against error and fraud, it is wise to reconcile the bank's figures to the company's regularly. Bank reconciliation is the process of comparing the bank statement (sent monthly, weekly or even daily by the bank) of a certain period with the cash book of the same time period. By doing this, errors or timing differences between the balance on the bank statement and the balance in the cash book can be identified and explained.

For example, a company has a bank statement for October with an ending balance of $1,745, whereas the company's cash book at the end of October shows a balance of only $483. After comparing the company's cash record and the bank statement, the accountant finds that:

1. On October 31, the bank statement shows a bank service charge of $70, which is not recorded in the cash book;
2. In October, the company issued checks totaling more than $30,000, out of which $1,332 had not yet been cleared by October 31.

To prepare a bank reconciliation in order to arrive at the correct amount of cash as at the end of October, we have two steps to follow:

1. Adjustments to the cash book to arrive at the correct balance which would be shown in the Statement of Financial Position at the corresponding date. In this example, the $70 service charge is missing from the cash book, and we should deduct it from the balance of $483, arriving at $413, which should be the correct amount of cash in the company's cash record on October 31.
2. Adjustments to the balance of the bank statement. The uncleared check of $1,332 should be deducted from the bank statement's balance of $1,745, arriving at $413, which corresponds to the amount we have in step 1. Thesefore, the above two parts of the reconciliation process would bring about the same result which is the amount of cash to be shown in the Statement of Financial Position at the period end.

Below is a more complicated example for students who are willing to have some deeper understanding of this topic.

Example 2-1

Mrs Khan is a sole trader. Her cash book as at December 31, 20X6 showed an overdraft balance of $600. The bank statement as at the same date showed that Mrs Khan was in credit with the bank by $130.

As Mrs Khan's accountant, when comparing the cash book with the bank statement, you found that:

a) Bank charges of $70 was shown in the bank statement but has not been recorded in the cash book.

b) According to Mrs Khan's instruction, the bank transferred interest received of $120 from Mrs Khan's savings account to her current account, recording the transfer on January 2, 20X7. Mrs Khan's cash book, however, credited this amount on December 31, 20X6.

c) Checks received, amounting to $800, had been entered in the cash book, but had not been credited* by the bank.

d) Checks issued, amounting to $1,000, had been entered in the cash book, but had not been presented to the bank by the payee.

e) The payments side of the cash book was added up wrongly; the total was $20 less than the correct amount.

f) A check of $100 issued from the savings account had been shown in the cash book as issued from the current account.
g) Dividends received amounting to $400 had been paid directly to the bank but not entered in Mrs Khan's cash book.
h) Mrs Khan issued a check of $50 to her supplier, who delayed in presenting the check to the bank, and this check was replaced when out of date. It was entered again in the cash book, no other entry was made. Both checks were included in the total of unpresented checks shown above.

Required: Prepare a bank reconciliation for Mrs Khan as at December 31, 20X6.

Solution:

		$		$
Cash book: balance on current account as at December 31, 20X6				(600)
Adjustments and Corrections:				
Add:				
(b)	Cash book was incorrectly credited with interest on December 31. It should have been debited with the receipt of interest.	120		
(b)	Debit cash book (current account) with transfer of interest from deposit account.	120		
(f)	Check drawn on savings account, not current account; add cash back to current account.	100		
(g)	Dividends received should be debited in the cash book.	400		
(h)	The replaced check issued to the supplier should be cancelled. The cash book should now be debited, since previous credit entry is no longer valid.	50		790
Less:				
(a)	Bank charges not yet known by the depositor.	(70)		
(e)	Mistake in adding up the credit side of the cash book.	(20)		(90)
Corrected balance in the cash book				100
Balance per bank statement as at December 31, 20X6				130
Add:				
(b)	Interest not yet recorded by December 31, 20X6.	120		
(c)	Check not yet cashed, but already recorded in the depositor's book.	800		920
Less:				
(d)	Unpresented checks	(1000)		

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(h)	The cancelled check to the supplier	50		(950)
Balance per corrected cash book				100

**Please note that, if a depositor deposits money in his bank account, the bank owes him that money, and the customer is therefore a payable of the bank. This means that if a business has $1,000 in the bank, the business will have a debit balance in its own cash book, but the bank's record will show a credit balance of the business' account. That is to say, the bank's records are a "mirror image" of the customer's own records, with debits and credits reversed.*

The main purpose of a bank reconciliation is: to keep a good internal control over cash by reconciling the company's records to the records of an independent source outside: the bank. By doing so, a business could detect any errors or misuse of cash as early as possible.

The job of making bank reconciliation is very important for effective cash control. It is best to assign this job to an independent person who does not take part in the recording of cash transactions. If these jobs are not properly separated, frauds are likely to occur.

REPORTING CASH ON THE STATEMENT OF FINANCIAL POSITION

On the Statement of Financial Position, companies often combine cash on hand, cash in banks and petty cash, and report the total as "Cash" in the current asset section. The term "Cash and Cash Equivalents" is also used by some companies to report cash. IAS 7 Statement of Cash Flows defines cash equivalents as short-term, highly liquid investments, readily convertible into known amounts of cash that are subject to an insignificant risk of changes in value. To qualify as cash equivalents, these investments must have maturities of three months or less. They include money market funds, bank certificates of deposit, etc. Others, such as cash in savings accounts subject to a statutory notification requirement and cash in certificates of deposits maturing during the current operating cycle or within one year may be presented in the Statement of Financial Position as current assets, but these items must be separately listed from Cash so that users are not misled by the impression that these funds are available immediately upon demand. Typically, such items are shown as "short-term investments," but these could also be separately labeled as time deposits or restricted cash deposits.

On the Statement of Financial Position, bank overdraft should also be included as a component of "cash" if such overdrafts are repayable on demand and are an integral part of a company's cash management. Otherwise, overdraft should be reported as a current liability.

COMPARISON OF IFRS AND CAS

In terms of cash, CAS has completely converged with IFRS. Cash is classified as financial assets and shown as current asset on the Statement of Financial Position. The recognition principles and others are the same.

EXERCISES

1. Londis Company set up a petty cash fund on May 1 with a balance of $100. During May the following petty cash receipts were found in the petty cash box:

Date	No.	Details	Amount
			$
May 6	1	Postage Expense	19.75
May 11	2	Freight-out	31
May 17	3	Miscellaneous Expense	4.5
May 25	4	Travel Expense	25.6
May 30	5	Miscellaneous Expense	2

The fund was replenished on May 31 when the fund had $17.15 in cash.

Required: Prepare the journal entries in May that pertain to the operation of the petty cash fund.

2. The bank statement of Savvy & Co. showed a balance of $31,814.90 on July 31, 2013. On this date, the business' cash book showed a balance of $23,178.90. The accountant of Savvy & Co identified the following reconciling items:

a. Deposits in transit: July 31 deposit was received and recorded by the bank on August 1, 2013. Amount: $4,402.8.

b. Outstanding checks: Check No. 1208, $6,000; No. 1223, $1,802.60; No. 1225, $3,005.40; these three checks were issued by Savvy & Co. but have not been presented to the bank as at July 31. Total amount: $11,808.

c. Errors: Savvy & Co. issued check No.1216 for $2,452 and the bank correctly paid that amount. But in the cash book, it was wrongly recorded as $2,524. Error amount: $72.

d. Bank charges and etc.:

i. Bank charge for printing business checks: $60.

ii. Collection of note receivable for $2,000 plus interest earned of $100, less bank collection fee of $30. Total amount: $1,070.

Required: Prepare bank reconciliation for Savvy & Co. as at July 31, 2013.

DISCUSSION QUESTIONS

1. "The use of a bank contributes significantly to good internal control over cash." Do you agree with the statement? Give your reasons.
2. "Cash equivalents are the same as cash." Do you agree? Please explain.
3. Sarah, a new student of accounting, is confused about the lack of agreement between the cash balance books and the balance per the bank. Please explain the causes for the lack of agreement to Sarah and give an example of each cause.
4. Michael runs a small business which owns the following assets at the reporting date:

a) Cash on hand in petty cash fund	$425
b) Cash in bank savings account	$4,000
c) Cash in bank current account	$6,000
d) Cash refund due from the Tax Office	$1,200
e) Postdated checks	$2,300

   What amount should Micheal report as Cash in the Statement of Financial Position?
5. Describe the operation of a petty cash fund and indicate the control features involved in the petty cash system.

KEY TERMS OF THIS CHAPTER

- **Cash equivalents:** Short-term, highly liquid investments that can be converted to a specific amount of cash.
- **Internal control:** All of the related methods and measures adopted within an organization to safeguard its assets and enhance the accuracy and reliability of its accounting records.
- **Petty cash fund:** A cash fund used to pay relatively small amounts of cash.
- **Bank reconciliation:** The process of comparing the bank's balance of an account with the company's balance. Differences between the balance on the bank statement and the balance in the cash book will be errors or timing differences, and the accountant should identify these mistakes or differences and explain them properly.