

# **Audit, Business Processes and Digitalization [BL 5]**

## **Business Level II | CA Sri Lanka**

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Study Text

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## **PART B: BUSINESS PROCESSES AND INTERNAL CONTROLS**

### **B.4: Cash Management**

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Doing business or running an organization is a series of activities/multiple activities carried out to achieve business goals/objectives. Activities carried out on 'CASH PAYMENTS & RECEIVABLES' is one such prime activity carried out by almost all of the organizations as cash is most liquid highly utilized asset which involves series of tasks pertaining to the organization.

Notes:

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### **B.4.1. Avoiding the use of bank notes and coins for receipts and payments**

When there is no electronic cash register for recording receipts of bank notes and coins, organizations should not accept payments or make payments in notes and coins (except in small petty cash amounts)

Businesses continually receive cash and pay out cash. Handling cash is a process in business where the risk of fraud and theft are probably the greatest. It is essential that

- All cash received is properly recorded
- Cash is kept secure
- All payments are for genuine business transactions and are not made fraudulently

### **B.4.2. Maintenance of a cash book**

All receipts and payments by cheque or bank transfer (or credit card) should be recorded in the cash book

All receipts of cash for payment into the business bank account, and all payments from the business bank account, should be fully recorded. They are recorded in a cash book

The cash book is a part of the bookkeeping system. It may be a manual file, but is more commonly a computer file within a computerized accounting system. It serves two purposes in the accounting system.

- It is a book of prime entry. It is the file where receipts and payments of cash are initially recorded.
- It is also an account in the double entry bookkeeping system (the general ledger)

### **Format of a cash book**

It is important to understand in general terms the nature of records in a cash book.



Debit side	Credit side
<b>To record cash received and paid into the bank account</b>	<b>To record payments from the bank account</b>
Cash may be received in the form of cheques, or they may be notified as electronic bank transfers by the person making the payment.	An accounting department may make payments by cheque or may make them as electronic bank transfers.
On this side of the cash book, the accountant records the total amount of each payment received. There is a separate line in the cash book or entry in the computer file for each receipt transaction.	On this side of the cash book, the accountant records the total amount of each payment that is made. There is a separate line in the cash book or entry in the computer file for each payment transaction.
There are also additional columns that analyse what the receipt consists of: for example, there may be additional columns for trade receivables (money received from a credit customer), cash sales, value added tax and sundry income.	There are also additional columns that analyse what the payment consists of: for example, there may be additional columns for trade payables (money paid to a supplier), administrative expenses paid, payroll payments, payments for non-current assets and so on.

### B.4.3. The current bank balance: balancing the cash book

The cash book is both a file for making the initial entries for cash received and cash payments (as a 'book of prime entry') and it is also an account in the double entry bookkeeping system (the general ledger)

In a computerized system, the current balance is adjusted automatically for each transaction that is entered into the system.

In a manual cash book system, the bank balance before making any new entries for transactions is shown as a balance brought forward. If there is money in the bank, this balance is shown on the receipts (debit) side of the cash book. If the account has an overdrawn balance, the opening balance is shown on the payments (credit) side

<b>Cash book</b>			
<b>Receipts (debit) side</b>		<b>Payments (credit) side</b>	
	Rs.		Rs.
2 May Opening balance	X	2 May Payments: one line for each transaction	X
Receipts: one line for each transaction	X		X
	<u>X</u>	Closing balance	<u>X</u>
3 May Opening balance	X		

#### **B.4.4. Recording cash received and banked**

All receipts and payments should be recorded in the cash book, and the accuracy of the cash book balance should be checked from time to time by means of bank reconciliations

#### **Banknotes and coins**

Most businesses do not like to receive banknotes and coins, because of the risks.

- An employee may simply take the money without recording the receipt, and if challenged can deny having received it.
- A customer may falsely claim to have made a payment in banknotes and coins

#### **Receiving payments by cheque**

When receipts are in the form of a cheque, each transaction is recorded on the receipts side of the cash book.

- When all the transactions have been entered in the cash book, a figure for total receipts by cheque is calculated from the cash book entries.
- The amounts of the physical cheques are also totaled.
- The total recorded in the cash book and the total value of the cheques should be the same amount. If they are not, an error has occurred and the accountant must go through the transactions again until the mistake is found and corrected

#### **Receiving payments by bank transfer**

When money is received from a customer by electronic bank transfer, the customer should notify the organization about the payment. (If the customer does not do this, the organization may not discover the payment until much later, and may not be able to recognize where the payment came from.)

#### **Cash receipts and the sales process**

When money is received from customers for goods sold on credit, the payment of a sales invoice must be recorded in the sales system. When money is received with an order for goods or services, the sales order must be entered into the sales system

#### **B.4.5. Making payments from the bank account**

All payments should be authorized at the appropriate management level before they are made

An organization may make all or most of its payments to suppliers on one day each week or one day each month (for example, on the last working day of each month)

Payments should be authorized by a responsible manager. Large payments should be authorized by a person at an appropriate level in the management hierarchy, in accordance with the organization's internal control system.

- Cheques are authorized by the process of signing them. Cheques for large amounts may require two signatures, to reduce the risk of fraud.
- Bank transfers are authorized by means of signing a list of the payment transactions

#### **Recording payments in the cash book**

Payments, whether by cheque or by bank transfer, should be recorded in the cash book. When all the payments have been recorded in the cash book, the total amount of payments in the cash book should be checked against:

- The total value of bank transfers on the file to be sent to the bank, or
- The total amounts of the cheques

#### **B.4.6. Bank reconciliations**

The cash book balance should be checked against the balance in the bank's records on a regular basis. This is done by comparing the cash book records with a bank statement that is provided by the bank. This is known as carrying out a bank reconciliation

The cash book balance should be checked against the balance in the bank's records from time to time. This is done by comparing the cash book records with a bank statement that is provided from time to time, perhaps each month, by the bank. (Alternatively, if the organization has online banking, it can check the bank's records online.) This is known as carrying out a bank reconciliation

The purpose of a bank reconciliation is to:

- Check whether the balance in the cash book and the balance in the bank's records can be made to agree
- Identify errors or omissions in the cash book
- Possibly (but not usually) identify mistakes that have been made by the bank

## **Differences between the cash book balance and the balance in the bank's records**

The balance in the bank's records and the balance in the cash book will not be the same. There are several reasons for this.

(a) When payments are received, it can take several days to clear the payment through the banking system. For example, when a cheque is paid into the bank, it may be several days before the money appears in the bank account.

(b) When payments are made, it may take some time for the payment to be deducted from the bank account. When a payment is made by cheque, the delay is caused by the time the cheque is in the post and the time that it takes the recipient of the cheque to pay it into their bank

### **B.4.7. Cash surpluses: making investments**

An organization may build up a temporary cash surplus. Cash held in a current bank account earns no interest.

Management may therefore decide to invest surplus cash for a short time, usually in investments where the risk of losing money is non-existent or small

### **B.4.8. The petty cash system**

Most businesses need to keep a small amount of cash to pay for small value items and to reimburse employees for expenses they have paid from their own money. This money is called petty cash

Most of the businesses need to access small amounts of notes and coins on occasion to make various small payments. It is convenient to have an amount specifically set aside for this purpose, rather than to hope there is cash from cash sales available whenever it is needed. This readily available value of notes and coins is known as petty cash

Examples of typical reasons for needing cash for purchases might include:

- Purchase of stationery or small items (such as water, milk or coffee) required in the office
- Payments for postage (postage stamps)
- Payment of casual, non-payroll wages, e.g. payment to a window cleaner
- Payments of taxi and bus fares needed for business travel by relevant staff

It would be inappropriate to draw up a cheque or authorize an automated payment each time these types of expense are incurred. Instead, a small amount of cash is kept for these purposes, known as the petty cash 'float'

## Transferring money into petty cash: the petty cash box

The petty cashier:

- (a) Makes a formal requisition for cash to be withdrawn from the bank account in notes and coins, for holding in petty cash. This is made on an appropriate requisition form.
- (b) The accountant responsible for the bank account arranges for the notes and coins to be provided and records the withdrawal of the money on the payments side of the cash book.
- (c) The same accountant may also be responsible for maintaining another cash book in the accounting system. This is the petty cash book, which records all receipts of notes and coins into petty cash and all payments from petty cash. The petty cash book also provides a record of the current balance of money held in petty cash.
- (d) On receipt of the banknotes and coins from the bank, the petty cashier puts them into a lockable petty cash box.

The petty cashier is responsible for the physical security of the petty cash box. The box may be kept in a locked drawer in the petty cashier's desk or may even be held in a safe in the office

### B.4.9. Payments of petty cash claims

Payments out of petty cash are made by filling out a petty cash voucher. The voucher should state the reason for the payment and the amount of the payment. It should be signed by the person receiving the cash and authorized by an appropriate person (who may be the petty cashier or an office manager). There must also be a receipt as evidence of the expenditure, and the receipt should be attached to the petty cash voucher

A key internal document for the proper functioning of a petty cash system is the petty cash voucher. This is completed by the petty cashier and authorized before any cash can be paid out of the petty cash box

PETTY CASH VOUCHER	
Number: 0463	Date: 1 June XX
Details	Amount
Coffee for office kitchen	Rs. 670
Net	Rs. 670
VAT	_____
Total	Rs. 670
Claimed by: P. Norris	
Authorised by: J. Smith	



There are a number of important points to note about a petty cash voucher:

- (a) It is prepared by the petty cashier in response to a request from an employee. The employee may be reclaiming a small amount of money that they have previously paid from their own pocket for a business purpose. In such cases, they must provide a receipt as evidence of the payment.
- (b) An employee may ask for petty cash to pay for an expense that has not yet been incurred, such as a bus fare. A petty cash claim may be authorized if the employee does not have any money to make the payment and reclaim it later. In such cases, the employee must subsequently provide a receipt and any change if the petty cash claim exceeds the amount of the actual payment.
- (c) If a small payment is made for another purpose, for example to pay a window cleaner, the petty cashier or an office manager should complete a petty cash voucher, get it authorized and obtain a receipt when the payment is made
- (d) Petty cash vouchers are generated with sequential numbers on them. In the example above, voucher number 0463 would be generated by an automated system. The purpose of sequential numbering is to ensure that every petty cash voucher and petty cash claim is accounted for. (The sequential numbering of petty cash vouchers is checked when the petty cash expenses are recorded in the petty cash book.)
- (e) The reason for the expense should be written on the voucher, and the receipt should be attached to the voucher.
- (f) If there is any value added tax in the payment, this should be recorded on the petty cash voucher.
- (g) The voucher is signed by the employee receiving the money and authorized by an appropriate person

#### **B.4.10. Recording petty cash claims in the petty cash book**

Petty cash vouchers for claims that have been paid should be kept in the petty cash box until they are taken for recording the payments in the petty cash book

A person in the accounts department should enter petty cash payments in the petty cash book

A petty cash book is similar to a cash book, with one side for notes and coins received and the other side for payments out of petty cash. The payments side of the petty cash book has a column for recording all payments and also additional analysis columns for recording the purpose for which the payment was made, such as travel, postage, general office expenses, and so on

#### B.4.11. Imprest system for petty cash

In an imprest system, there is a maximum amount of cash that can be held in petty cash. This is the imprest amount. When cash in the petty cash box is getting low, the money is topped up to the imprest amount. At the same time, a check should be made that the value of voucher claims in the petty cash box plus the cash remaining in the box add up to the imprest amount

The principle of an imprest system is as follows. When the petty cash system is first set up, a certain sum of cash, say Rs. 10,000, is put into the petty cash box. This is the imprest amount. In order for any money to be paid out of the petty cash box a valid, authorized petty cash voucher must be created. The vouchers for petty cash claims (once the money that they represent has been paid out) are also kept in the petty cash box. Therefore, at any point in time, the amount of cash in the box plus the total of the vouchers should equal the imprest amount

	Rs.
Imprest amount at start of period	10,000.00
Petty cash paid out = vouchers	<u>(7,240.00)</u>
Cash remaining in box	2,760.00
Cash withdrawn from bank to restore imprest amount	<u>7,240.00</u>
Cash at start of next period = imprest amount	<u><u>10,000.00</u></u>

#### B.4.12. Business risks in the cash management process

It should be apparent from the description of cash management in this chapter that there are business risks in the process.

The potential risks are so high that, unless an organization has an electronic cash register for recording payments by bank notes and coins, it is unlikely to accept notes and coins in payment from customers.

The risks of theft and disputes with customers about missing cash would be too high. Similarly, risks with making payments in notes and coins, unless for petty cash items, would be too great

#### Risks and the cash book

There is a risk that receipts will be recorded incorrectly. Cash receipts and cash payments should be recorded in the cash book. There is a risk that receipts will be recorded incorrectly. Daily totals of receipts in the cash book should be compared with the total value of cheques banked and money received by bank transfer: any differences would probably indicate an error in the cash book records

## Risks and petty cash

The main risk with petty cash is that money may be stolen, or unauthorized payments may be made from the petty cash box.

Controls to reduce these risks have been described.

- An individual, the petty cashier, should be made personally responsible for petty cash.
- Petty cash should be kept in a locked box, and the locked box should be kept in a secure place.
- The imprest amount should not be excessive.
- All payments from petty cash should be authorized.
- There must be a voucher for every petty cash claim. All vouchers should be signed by the person taking the cash and the person authorizing the payment.
- There should be a receipt for all payments from petty cash
- There should be regular checks that the amount of money still held in petty cash is correct. This can be done at the same time that a requisition is prepared to top up the imprest amount, by checking that the money in the petty cash box plus the value of petty cash claims (since the previous top up) equals the imprest amount.
- All petty cash transactions should be recorded in the petty cash book. The balance in the petty cash book should be checked occasionally against the money actually held in the petty cash box



## Chapter review questions

1. In an imprest system, what amount should the petty cashier claim from the cashier in the accounting department when topping up the money in petty cash to the imprest amount?
2. Vouchers for petty cash claims should be supported by a \_\_\_\_\_
3. In a bank reconciliation, which of the following require new entries to be made in the cash book?
  - A. Payments made to suppliers that have not yet been deducted from the organization's bank balance
  - B. Payments received from customers that have been banked but have not yet been cleared by the bank
  - C. Bank charges
  - D. Customers' cheques returned as unaccepted by the bank
4. State two internal controls that may be applied to the payment by cheque of a large amount of money to a supplier?
5. Petty cash vouchers should be signed by the person \_\_\_\_\_ the cash and the person \_\_\_\_\_ the payment
6. An employee takes Rs. 400 from petty cash to buy postage stamps for the office. The stamps cost Rs. 360. What should the employee do on returning with the stamps to the office?

