

THEME: PETTY CASH

By John W. Day, MBA

ACCOUNTING TERM: Petty Cash

Petty Cash is a predetermined amount of cash on hand. The purpose of having a petty cash fund is to provide easy and quick access to a cash source in order to pay for small expenses “on the fly”. Petty cash is also known as an “imprest fund”, whereby the fund is replenished in exactly the amount that is expended from it.

FEATURE ARTICLE: Why Petty Cash?

Why Petty Cash? It is the difference between sloppy bookkeeping and managing your money properly. You have your own small business, so why not grab a twenty out of the till when you need some pocket money? It may not be the end of the world if you do, but it presupposes a certain attitude toward your business.

Keeping track of your finances is one of the most important tasks a business owner has. A lackadaisical approach in this area can spell trouble. For instance, I’ve seen owners who are shocked to find a major discrepancy between the cash receipts and the sales when they are reconciled at the end of the month. They had no idea they were taking that much money out for lunches, etc. In addition, what if you have employees who decide they can dip into the till? There is no way to know who took the cash, the owner or the employee. In accounting, this is an issue known as “Internal Control”. Internal controls are established to maintain the integrity of the accounting system. These are procedures that provide checks and balances to ensure that the figures reported on a financial statement are what they say they are.

In a small business that is large enough to have employees who handle bookkeeping functions such as preparing a bank reconciliation, making bank deposits, and recording entries into the general ledger, an internal control procedure known as the “division of labor” should be instituted. Division of labor means that the same person preparing the bank reconciliation should not also make the bank deposits. The theory here is that it is less likely that two employees will “collude” with each other to commit a crime.

The petty cash system is part of a company’s internal control procedures. A set amount, such as \$100 is established by withdrawing the cash from the bank and placing it in a separate locked box. When cash is removed from the box, a voucher is filled out for the exact amount of cash and signed by the person removing the cash. This voucher amount and the remaining amount of cash in the box must total \$100. When the item is purchased, the receipt is placed in the

box in lieu of the voucher. If the box were audited, the auditor would find receipts, vouchers, and cash that equal \$100.

You can find locking cash boxes and pads of petty cash voucher slips at your local stationer's store. If your business is small enough not to warrant a petty cash box, then you should at least use the voucher slips to replace any money you take out of the cash register till. Follow the same procedures above, and you will always know where your cash went and what it was spent for.

QUESTION: How Is Petty Cash Replenished?

How to properly replenish petty cash has been a source of confusion for many small business owners. As a practicing accountant, I find clients making the same mistake constantly, and it comes from not understanding the full concept of petty cash. The concept is not difficult to understand; you just need to make sure you understand it.

First, think about what you are doing. You take a certain amount of money out of the bank; let's say \$100, and put it into a cash box. Remember, that Cash-in-Bank is an asset. An asset, you may recall, if you have taken my Accounting for Non-Accountants course, is an unused economic resource that your business owns (has possession or control of). All you have done, is shift \$100 from Cash-in-Bank to another asset account called Petty Cash. You deplete the cash in the box when you purchase such items as postage, office supplies, meals, gas for an auto, etc. When most of the cash is gone, you must replenish the fund. You do that by withdrawing more cash from the bank for the amount that has been depleted; let's say \$92.50. You should have \$92.50 in receipts for expenses in the box. Those expenses are posted to their respective categories and the offset is, of course, Cash. Here is the journal entry:

DESCRIPTION	DEBIT	CREDIT
Postage	37.00	
Office	14.50	
Meals	36.50	
Auto	15.00	
Cash		92.50
To record petty cash expenses for the month		

The mistake occurs when you try to do this:

DESCRIPTION	DEBIT	CREDIT
Petty Cash	92.50	
Cash		92.50
To record petty cash expenses for the month		

If you went with this second journal entry, you would end up with \$192.50 in the Petty Cash account, which is an asset on your balance sheet, and zero in the expense accounts for postage, office, meals, and auto. This doesn't seem right, does it? If you audited the petty cash box you would not find \$192.50 in cash, vouchers and receipts. You would only find \$100.00. The Petty Cash amount remains the same as originally established, unless you purposefully decide to increase it. Otherwise, petty cash expenditures must be recorded to their appropriate expense categories.

TIP: How To Record Out-Of-Pocket Expenses.

Out-of-pocket expenses are not the same as petty cash expenses in that the money used for the expenses is personal money not business money. The challenge is how to reimburse yourself or an employee for personal money used for business expenses. The obvious way is to write a check to yourself or the employee for the receipts for the business expenditures. When that check is written, you simply code the check to the appropriate expense account. For example:

DESCRIPTION	DEBIT	CREDIT
Freight	11.50	
Cash		11.50
To record reimbursement to Sally Jones for freight		

But, what if the amount is your personal money and it is a small amount. It doesn't seem worth writing a check for \$3.42 or some such amount. If you are a sole proprietor, why not save all the out-of-pocket receipts until the end of the month, quarter, or year, and write a journal entry that decreases your Owner's Draw account? For instance:

DESCRIPTION	DEBIT	CREDIT
Postage	3.42	
Auto	15.00	
Office	65.00	
Owner's Draw		83.42
To record out-of-pocket expenses for the month		

You have been taking personal draws during the year, however, you used some of that money for business purposes. In reality, you did not take as much out for personal use as you previously recorded, therefore, you are entitled to reduce the owner's draw by the amount of business expenses.

This same system can work for a partner or an officer of a corporation. For a partner, use the account for partner draws, such as, Guaranteed Payments for the credit. For an officer who takes advances on salary, use the Officer Advance account for the credit.

A tip for partners of a partnership in the U.S., is to make sure that you include in your partnership agreement that out-of-pocket expenses will be reimbursed directly to the partner. U.S. tax law requires that this procedure be stipulated in the partnership agreement for out-of-pocket expenses from the partners to be deductible. Besides, if a partner does not get reimbursed for out-of-pocket expenses, he will have to report them on Schedule A of his 1040 tax return as a miscellaneous itemized deduction to get a tax benefit. The problem with doing things this way is that miscellaneous itemized deductions are reduced by 2% of the individual's adjusted gross income beforehand. This means, depending on the amount of your adjusted gross income, you are going to lose part of your deduction. Better to let the partnership take the full deduction for your out-of-pocket expenses.

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