

Managing Petty Cash, Bank Reconciliations, and Payroll Systems

These three subsystems form the **cash management backbone** of a small business. Together, they ensure that **every dollar is controlled, verified, and recorded** — from small incidental payments to employee payroll and bank reconciliation.

A. Petty Cash Management

1. Purpose

Petty cash is a **small fund** used for day-to-day, minor expenses that are impractical to pay by check or electronic transfer — such as postage, office supplies, or parking fees. It provides convenience but requires **tight control** to prevent misuse.

2. Key Concepts

- Operates under the **imprest system**

An imprest system is a financial management method for controlling small expenses by maintaining a fixed cash amount, which is then replenished as money is spent:

$$\text{Cash on hand} + \text{Receipts} = \text{Fixed Fund Balance}$$

- Only one **authorized custodian** handles the fund.
 - The fund is replenished by check when receipts accumulate.
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3. Example

Assume a \$200 petty cash fund.

Date	Voucher #	Description	Amount
4/05	001	Office supplies	\$15
4/09	002	Postage	\$8

Date	Voucher #	Description	Amount
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4/12	003	Coffee for a meeting	\$10
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At month-end:

- **Cash remaining:** \$167
- **Receipts:** \$33
- **Total:** \$200

Replenishment journal entry:

Debit: Office Supplies Expense \$15

Debit: Postage Expense \$8

Debit: Miscellaneous Expense \$10

Credit: Cash (Bank) \$33

4. Best Practices

- Limit fund size to what's necessary.
 - Require receipts for all payments.
 - Use **numbered petty cash vouchers**.
 - Lock fund securely.
 - Reconcile and replenish monthly.
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B. Bank Reconciliation

1. Purpose

Bank reconciliation compares the **business's ledger cash balance** to the **bank statement balance** to ensure accuracy, detect errors, and prevent fraud.

2. Steps

1. Obtain a monthly **bank statement**.
 2. **Compare** deposits, withdrawals, and checks.
 3. **Identify timing differences:**
 - Outstanding checks (recorded but not cleared)
 - Deposits in transit (recorded but not yet credited)
 4. **Adjust** for bank service charges, interest, or NSF checks.
 5. Verify that **adjusted book balance = adjusted bank balance**.
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3. Example (April 30)

Bank statement balance	\$12,450
+ Deposits in transit	+\$1,200
– Outstanding checks	–\$950

Adjusted bank balance \$12,700

Book balance	\$12,500
+ Interest earned	+\$50
– Bank service charge	–\$20

Adjusted book balance \$12,530

 The difference (\$170) requires investigation — perhaps a missing deposit or unrecorded charge.

4. Best Practices

- ✓ Reconcile monthly.
 - ✓ Have **someone other than the check writer** perform reconciliations.
 - ✓ Mark cleared items to prevent duplication.
 - ✓ Retain reconciliation reports and statements.
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C. Payroll System Management

Payroll is often the **largest and most sensitive expense** for a small business. It involves **accurately calculating earnings, deductions, taxes, and employer contributions**, and recording them in compliance with tax laws.

1. Key Components

Component	Description
Gross Pay	Total wages earned (before deductions)
Deductions	Taxes and benefits withheld from employee pay
Net Pay	Amount employee actually receives
Employer Taxes	Additional costs paid by the employer (not deducted from employee)

2. Payroll Process

1. **Collect time data** (hours worked or salary due).
 2. **Calculate gross pay** and all deductions.
 3. **Compute employer's payroll taxes.**
 4. **Prepare paychecks/direct deposits.**
 5. **Record journal entries** for wages and taxes.
 6. **Submit payroll taxes** to IRS and state agencies.
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3. Example Payroll Entry (Full Breakdown)

Scenario

- **Employee:** Maria Lopez
- **Pay Period:** Weekly
- **Gross Pay:** \$1,000

Employee Deductions

Deduction	Rate / Basis	Amount (\$)	Explanation
Federal Income Tax	12%	120.00	Based on tax table / Form W-4
State Income Tax	4%	40.00	Withheld for state obligations
Social Security (FICA)	6.2%	62.00	Employee share
Medicare (FICA)	1.45%	14.50	Employee share
Health Insurance	Flat deduction	50.00	Employee contribution
Retirement Plan (401k)	3%	30.00	Employee contribution
Total Deductions		316.50	

Net Pay = Gross Pay – Total Deductions = \$1,000 – \$316.50 = \$683.50

Employer Payroll Taxes (Employer's Cost)

Tax / Contribution	Rate / Basis	Amount (\$)	Notes
Social Security (FICA)	6.2%	62.00	Employer match
Medicare (FICA)	1.45%	14.50	Employer match
Federal Unemployment (FUTA)	0.6%	6.00	Employer only
State Unemployment (SUTA)	2.5%	25.00	Employer only
Employer 401(k) Match	3%	30.00	Matches employee's contribution

Tax / Contribution	Rate / Basis Amount (\$)	Notes
Total Employer Payroll Taxes	137.50	

Summary of Payroll

Category	Amount (\$)
Gross Pay	1,000.00
Employee Deductions	(316.50)
Net Pay (Take-home)	683.50
Employer Payroll Taxes	137.50
Total Payroll Cost to Employer	1,137.50

Journal Entries

1. Record Gross Payroll and Employee Deductions

Debit: Salaries Expense	\$1,000.00
Credit: Federal Income Tax Payable	\$120.00
Credit: State Income Tax Payable	\$40.00
Credit: Social Security Tax Payable	\$62.00
Credit: Medicare Tax Payable	\$14.50
Credit: Health Insurance Payable	\$50.00
Credit: Retirement Contributions Payable ...	\$30.00
Credit: Cash (Net Pay to Employee)	\$683.50

2. Record Employer Payroll Tax Expense

Debit: Payroll Tax Expense	\$137.50
Credit: Social Security Tax Payable	\$62.00
Credit: Medicare Tax Payable	\$14.50

Credit: FUTA Payable \$6.00
 Credit: SUTA Payable \$25.00
 Credit: Employer Retirement Match Payable .. \$30.00

3. Record Payment of Payroll Taxes and Benefits (When Paid)

Debit: Federal Income Tax Payable \$120.00
 Debit: State Income Tax Payable \$40.00
 Debit: Social Security Tax Payable \$124.00
 Debit: Medicare Tax Payable \$29.00
 Debit: FUTA Payable \$6.00
 Debit: SUTA Payable \$25.00
 Debit: Retirement Contributions Payable \$60.00
 Debit: Health Insurance Payable \$50.00
 Credit: Cash \$454.00

D. Unified System to Manage Petty Cash, Bank Reconciliation, and Payroll

Subsystem	Purpose	Records / Tables	Best Practice Controls
Petty Cash	Track minor expenses	petty_cash_transactions	Numbered vouchers, receipts, monthly replenishment
Bank Reconciliation	Verify bank vs. ledger	bank_statements, reconciliation_records	Separate preparer and approver, store PDFs
Payroll	Pay employees, manage taxes	employees, payroll_entries, payroll_deductions, employer_taxes	Separate approval and processing, confidential storage

Sample Oracle SQL Table (Petty Cash Example)

```
CREATE TABLE petty_cash_transactions (  
    trans_id NUMBER GENERATED BY DEFAULT AS IDENTITY,  
    trans_date DATE,  
    description VARCHAR2(100),  
    amount NUMBER(10,2),  
    voucher_no VARCHAR2(20),  
    approved_by VARCHAR2(50),  
    file_path VARCHAR2(200), PRIMARY KEY (trans_id) );
```

System Workflow

1. **Petty Cash:** Vouchers and receipts entered into system → monthly reconciliation → replenishment check.
 2. **Bank Reconciliation:** Import statement → match ledger items → adjust discrepancies → file report.
 3. **Payroll:** Time data input → payroll calculated → journals auto-post → liabilities scheduled for payment.
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Summary

Managing **petty cash**, **bank reconciliations**, and **payroll systems** ensures that a business's most liquid asset — **cash** — is controlled with precision.

When integrated into one well-organized accounting system:

- Petty cash provides flexibility for small expenses.
- Bank reconciliation maintains accuracy and prevents fraud.
- Payroll system ensures compliance and accurate compensation.

Together, they safeguard the financial health of the business.