Cash and Highly-Liquid Investments

Part 2

Your goals for this “cash and highly-liquid investments” chapter are to learn about:

- The composition of cash and how cash is presented on the balance sheet.
- Cash management and controls for receipts and disbursements.
- Reconciliation of bank accounts.
- The correct operation of a petty cash system.
- Accounting for highly-liquid investments known as “trading securities.”

6. Cash Composition

Given its liquid and vital status, cash is typically listed first within the current asset section of the balance sheet. But what exactly is cash? This may seem like a foolish question until one considers the possibilities. Obviously, cash includes coins and currency. But what about items like money on deposit in bank accounts, undeposited checks from customers, certificates of deposit, and similar items? Some of these are deemed to be cash and some are not. What rule shall be followed? Generalizing, cash includes those items that are acceptable to a bank for deposit and are free from restrictions (i.e., available for use in satisfying current debts). Cash typically includes coins, currency, funds on deposit with a bank, checks, and money orders. Items like postdated checks, certificates of deposit, IOUs, stamps, and travel advances are typically not classified as cash. The existence of compensating balances (amounts that must be left on deposit and cannot be withdrawn) should be disclosed; if such amounts are very significant, they are reported separately from cash. Also receiving separate treatment are "sinking funds" (monies that must be set aside to satisfy debts) and heavily restricted foreign currency holdings (that cannot easily be converted into dollars). These unique categories of funds may be reported in the long-term investments category.

6.1 Cash Equivalents

In lieu of reporting "cash," some companies will report "cash and cash equivalents." Cash equivalents arise when companies place their cash in very short-term interest-earning financial instruments that are deemed to be highly secure and will convert back into cash within 90 days. Many short-term government-issued securities (e.g., treasury bills) meet these conditions. In addition, active markets exist for such securities, and these financial instruments are usually very marketable in the event the company needs access to funds in advance of maturity. Cash management strategies dictate that large amounts of cash not be held in "unproductive" accounts that do not generate interest income. As a result, surplus cash is often invested in these instruments. Because of their unique nature, they are considered to be cash equivalents, and are often reported with cash on the balance sheet. Following is an excerpt from a recent balance sheet of the automotive division of General Motors Corporation. You will note that the company held over $15 billion in cash:

Cash and cash equivalents (Note 1) $ 15,187

Note 1 to the financial statements included this additional commentary about cash:

> Cash and Cash Equivalents
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> > Cash equivalents are defined as short-term, highly-liquid investments with original maturities of 90 days or less.