CASH

Cash is the standard medium of exchange that provides a basis for measuring and recording the value exchanged between two parties involved in a transaction. To be included as cash, an item must be readily available to pay current debts, and it must be free of any restriction that limits its usage. Coins, currencies, traveler's checks, certified checks, cashier's or personal checks, IOUs, cash kept on hand as a petty fund, bank drafts, funds and deposit at the bank are all examples of cash.

For reporting purposes, cash is first listed in the balance sheet because it is the most liquid of all current assets. However, *restricted cash, bank overdrafts,* and *cash equivalents* must be disclosed as separated from free cash balance. In addition, an unused portion of *a credit line (LC)* that does not appear as an asset or a liability in the balance sheet are disclosed in the notes accompanying to the financial statements because they increase the company's solvency.

Restricted Cash

Cash may be restricted by contractual requirements, or it may be set aside for particular purposes. Maintaining a minimum cash balance, called *compensating balance,* in checking or saving accounts for corporations is often required by banks and lending institutions that lend money to them. A compensating balance supports borrowing arrangements of the corporation with the lending institution, or it may be a payment for bank services for which there is no direct fees such as check processing and lockbox services.

However, cash is not always restricted by contracts. Some companies, for example, may often decide to maintain special funds voluntarily for purposes such as dividend payments, and plant expansion in the future. These funds are also considered as restricted cash. Regardless of the purpose for which the use of cash is limited, cash restricted may be classified as either short-term or long-term for reporting purposes, depending on the date of availability or disbursement.

Bank Overdrafts

Bank overdrafts occur when a check is written for more than the amount in the bank account. In fact, some companies may have arranged with the bank for paying their checks to the holder even when there is no enough cash in the bank account. In doing so, the company actually receives a short-term loan from the bank. Bank overdrafts should be reported in the current liability section and are usually added to the amount reported as accounts payable. Offsetting bank overdrafts against the bank account is permitted when enough cash is available in another account in the same bank on which the overdraft occurred.

Cash Equivalents

Cash equivalents are short-term investments that are highly liquid. These can be converted into known amount of cash easily and without significant risk of interest rates' changes. Treasury bills, commercial papers (very short-term notes payable issued by credit-worthy corporations), and money market funds are examples of cash equivalents. Cash equivalents have maturities of three months or less when purchased. Because of high liquidity of such instruments, some companies may combine their cash equivalents with the bank balances in the balance sheet.

Cash Management

The term cash management refers to planning, controlling, and accounting for cash transactions and cash balances. Because cash moves so readily between bank accounts and other financial assets, cash management really means the management of all financial resources. Efficient management of these resources is essential to the success—even to the survival—of every business organization. The basic objectives of cash management are providing accurate accounting for cash transactions and balances, preventing or minimizing losses from theft or fraud, anticipating the need for borrowing, and preventing excess amount of cash from sitting idle in the bank accounts with no revenue.

Control over Cash

Cash is the most liquid and most readily acceptable asset. Therefore, special internal controls must be established over cash transactions. Internal control over cash is sometimes regarded merely as a means of preventing fraud and theft. A good system of internal control, however, will also aid in achieving the other objectives of efficient cash management, including accurate accounting for cash transactions, anticipating the need for borrowing, and maintenance of adequate but not excessive cash balances. Bank accounts, bank reconciliation, petty cash funds, voucher system, cash short and over account, cash change fund, cash registers, printed receipts, safes, and separate recording of cash receipts and cash payments are the most common devices used to control over cash transactions of which some are explained below.

Bank Account

One of the major devices for maintaining control over cash is the *bank account.* To obtain the most benefit from a bank account, all cash received must be deposited in the bank and all payments must be made by checks drawn on the bank account. Periodically, the bank mails to the depositor a statement of account. This statement should be reconciled with the depositor's records by preparing *bank reconciliation.*

Bank Reconciliation

As an important part of the system of internal control, bank reconciliation is prepared to explain the differences between the cash balance shown on the bank statement and the cash amount in the company's checkbook. Bank reconciliation helps locate missing transactions and errors made by the company and by the bank. Unrecorded transactions that revealed must be recorded in the journals, and discovered errors must be corrected by making an adjusting entry in the journals.

Common differences between bank statement and accounting records of the company come from several sources. Outstanding checks, deposits in transit, service charges, charges for not sufficient funds checks (NSF), credits for interest earned, and miscellaneous bank charges and credits are the sources of inequality between the bank statement and the company books. Bank reconciliation can be prepared using four different formats: *1) book to bank, 2) bank to book, 3) book-and-bank to correct cash*, and *4) comprehensive reconciliation.*

Petty Cash Fund

A special cash fund, called *petty cash* also *imprest fund* or *revolving fund*, may be used by businesses to make small payments that occur frequently, for which payment by checks would cause delay, annoyance, or excessive expense of maintaining records. The amount of money maintained in a petty cash fund is placed in the custody of a specific employee, who authorizes disbursements of the fund according to specific restrictions as to maximum amount and purpose. When the amount of money in the petty cash fund is reduced to a predetermined minimum amount, the fund is replenished. Different cash funds may be established by businesses for purposes such as travel, selling, and other operating expenses.

Voucher System

A *voucher system* establishes control over cash payments. It is made up of records, methods, and procedures used in proving and recording liabilities, and in making and recording payments. Under this system, all expenditures must be authorized; the goods or services must be inspected, received, and reported; and the proper amount must be paid in a timely fashion. These verifications as well as authorization for payment are recorded on a voucher as the heart of the system. Other names for a voucher are *invoice approval form* and *check authorization.*

In a typical voucher system, the accounting department is responsible for approving cash payments and for recording the transactions. In approving expenditures, the accounting department will examine such supporting documents as the supplier's invoice, the purchase order, and the receiving report. Once payment has been approved, the accounting department signs a voucher authorizing payment and records the transaction in the accounting documents.

The voucher and supporting documents are then sent to the treasurer or other official in the finance department. This official reviews the voucher and the supporting documents before issuing a check. When the check is signed, the voucher and supporting documents are perforated or stamped "PAID" to eliminate any possibility of being presented later in support of another check.

Information from vouchers is recorded in a special journal called the *voucher register*. When a check is drawn to pay a liability, it is recorded in the check register and in the voucher register as well. Because of the importance of taking advantage of all purchases discounts, a business may use a separate account, called *Discounts Lost*, to account for any discounts not taken during the discount period. When this method is used with the voucher system, all vouchers are prepared and recorded at the net amount, assuming that the discount will be taken.

COMPREHENSION PRACTICE

A. *Short-Answer Questions:*

1. What is the definition of cash in accounting terms?
2. What are four different formats of bank reconciliation?
3. What document is prepared to find missing transactions and errors made by the bank and by the company?
4. What does business enterprises use to make small payments for which drawing checks is not practical?
5. What is a voucher system used for?
6. What are the main objectives of cash management?
7. What are the main causes of differences between cash balance in the company books and in the bank statement?
8. How does a company report cash in the balance sheet?
9. Name some of devices to establish control over cash transactions.
10. What does the term cash management refer to?
11. In reporting cash, three items must be disclosed separately. What are they?
12. Why lines of credit (LC) must be disclosed?
13. Why do some companies use a discount loss account?

B. *True-or-False statements:*

1. Those assets that are readily available to pay current debts, and ar[e] free of limitation in usage are cash.