CASH & CASH EQUIVALENTS
KARIM G. ABITAGO, CPA

Cash & Cash Equivalents Composition & Other Topics

Cash

Definition
Cash includes money and any other negotiable instrument that is payable in money and acceptable by the bank for deposit and immediate credit.

Recognition
Since there is no specific standard governing cash and cash equivalents, the related standard is *. The only guidance is found in PAS 1, paragraph 66, which provides that “an entity shall classify an asset as current when it is cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the end of reporting period.” In conclusion, to report an item as part of cash, it should be UNRESTRICTED IN USE.

Measurement

<table>
<thead>
<tr>
<th>Item</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in local currency</td>
<td>at face value</td>
</tr>
<tr>
<td>Cash in foreign currency</td>
<td>at face value but translated to Philippine Peso using closing rate at year-end</td>
</tr>
<tr>
<td>Cash in closed bank or banks in bankruptcy</td>
<td>estimated realizable value</td>
</tr>
</tbody>
</table>

Composition
To properly understand the composition of cash, we will group its parts into three (3): cash on hand, cash in bank and cash fund.

<table>
<thead>
<tr>
<th>Category</th>
<th>Items</th>
<th>Part of cash?</th>
<th>Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash on Hand</td>
<td>Coins and currencies</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Checks</td>
<td>Normal customer's checks</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cashiers’, Managers’ &amp; Travelers’ check</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Undelivered &amp; Post-dated checks</td>
<td>✔</td>
<td>revert to payable</td>
</tr>
<tr>
<td></td>
<td>drawn by the entity</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td></td>
<td>drawn by another person or entity</td>
<td>x</td>
<td>receivable</td>
</tr>
<tr>
<td></td>
<td>drawn by the entity</td>
<td>✔</td>
<td>revert to payable / other income</td>
</tr>
<tr>
<td></td>
<td>drawn by another person or entity</td>
<td>x</td>
<td>receivable</td>
</tr>
<tr>
<td>Other instruments</td>
<td>Money order</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank drafts</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Cash in bank</td>
<td>Demand deposit (Non-interest bearing)</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Savings deposit (Interest bearing)</td>
<td>✔</td>
<td>long-term investment</td>
</tr>
<tr>
<td></td>
<td>Escrow deposit (Interest bearing)</td>
<td>x</td>
<td>cash equivalent</td>
</tr>
<tr>
<td></td>
<td>Time deposit (Interest bearing)</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Compensating balance unrestricted/informal * if silent</td>
<td>✔</td>
<td></td>
</tr>
</tbody>
</table>
### Cash & Cash Equivalents

**Effectiveness. Efficiency. Convenience**

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**KARIM G. ABITAGO, CPA**

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**CASH & CASH EQUIVALENTS**

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**MAY 2021 CPA REVIEW SEASON**

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<table>
<thead>
<tr>
<th>Bank overdraft</th>
<th>restricted/formal</th>
<th>x</th>
<th>restriction is more than 12 months - long-term investments restriction is 12 months or less - short-term investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>General rule &amp; if silent</td>
<td>x</td>
<td>current liability</td>
<td></td>
</tr>
<tr>
<td>exceptions: (a) 2 or more accounts with the same bank</td>
<td>✔</td>
<td>offset from other bank accounts</td>
<td></td>
</tr>
<tr>
<td>(b) immaterial</td>
<td></td>
<td>offset from other cash accounts</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>for asset acquisition</th>
<th>current asset</th>
<th>✔</th>
<th>non-current asset</th>
<th>x</th>
<th>long-term investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>for use in operations</td>
<td>Examples: change fund; payroll fund, revolving fund, petty cash fund; travel fund</td>
<td>✔</td>
<td>Examples: interest fund; dividend fund; tax fund</td>
<td>✔</td>
<td>长短期投资</td>
</tr>
<tr>
<td>for settlement of liabilities</td>
<td>current liability</td>
<td>Examples: pension fund; contingent fund; insurance fund; bond sinking fund</td>
<td>x</td>
<td>long-term investment</td>
<td></td>
</tr>
<tr>
<td>non-current liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Accounting for Petty Cash Fund

Petty cash fund is money set aside to defray relatively small amount of cash disbursements. Petty cash fund may be accounted for using the following methods:

(a) Imprest fund system

(b) Fluctuating fund system

#### Summary of journal entries

**Imprest Fund System**

A. Establishment

<table>
<thead>
<tr>
<th>Petty cash fund</th>
<th>xx</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in bank xx</td>
<td></td>
</tr>
</tbody>
</table>

B. Payment of expense

<table>
<thead>
<tr>
<th>Memo entry only</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses xx</td>
</tr>
<tr>
<td>Petty cash fund xx</td>
</tr>
</tbody>
</table>

C. Replenishment

| Expenses xx |
| Cash in bank xx |

D. A.E for unreplenished fund

| Expenses xx |
| Cash in bank xx |

E. Increase in the fund

| Petty cash fund xx |
| Cash in bank xx |

F. Decrease in the fund

| Petty cash fund xx |

#### Fluctuating Fund System

| Petty cash fund xx |
| Cash in bank xx |

#### Other Topics

**Fraudulent activities in cash**

(a) Lapping - consists of misappropriating a collection from one customer and concealing this defalcation when collection is made from another customer.

(b) Window dressing - is a practice of opening the books of accounts beyond the close of the accounting period for the purpose of showing a better financial position and performance. Window dressing is usually perpetrated as follows:

1. By recording as of the last day of the accounting period collections made subsequent to the close of the period.
2. By recording as of the last day of the accounting period payments of accounts made subsequent to the close of the period.

(c) Kiting - is a transfer of cash from one bank to another bank. Kiting is usually employed at the end of the month. Kiting occurs when a check is drawn against a first bank and depositing the same check in a second bank to cover the shortage in the latter bank.
Accounting for cash shortage and overage

<table>
<thead>
<tr>
<th>Summary of journal entries</th>
<th>Cash Shortage</th>
<th>Cash Overage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Upon discovery</td>
<td>Cash short / over xx</td>
<td>Cash on hand xx</td>
</tr>
<tr>
<td></td>
<td>Cash on hand xx</td>
<td>Cash short / over xx</td>
</tr>
<tr>
<td>B. Upon investigation</td>
<td>Due from cashier xx</td>
<td>Cash short / over xx</td>
</tr>
<tr>
<td>(cashier is accountable)</td>
<td>Cash short / over xx</td>
<td>Due to cashier xx</td>
</tr>
<tr>
<td>C. Upon investigation</td>
<td>Loss from shortage xx</td>
<td>Cash short / over xx</td>
</tr>
<tr>
<td>(cannot trace anymore)</td>
<td>Cash short / over xx</td>
<td>Other income xx</td>
</tr>
</tbody>
</table>

Cash Equivalents

**Definition**

PAS 7, paragraph 6, defines cash equivalents as *short-term and highly liquid investments* that are *readily convertible into cash* and so *near their maturity* that they present insignificant risk of changes in value because of changes in interest rates.

**Recognition**

Only *debt instruments* acquired within 3 months or less before their maturity date can qualify as *cash equivalents*.

Note: Equity securities cannot qualify as cash equivalents since they do not have maturity date, except redeemable preference shares (with mandatory redemption) that are acquired 3 months before their redemption date can qualify as cash equivalents.

**Composition**

Examples of cash equivalents are:

(a) Time deposit
(b) Money market instrument or commercial paper
(c) Treasury bills

**NOTE:**

1. If an item cannot be included as cash equivalent because it did not qualify the cut-off time period, it will be classified as investments, short-term or long-term, depending on the period up to maturity.
2. If the problem is silent with regards to the above items (a-c), they are classified as cash equivalents.

Bank Reconciliation

**Definition**

A bank reconciliation is a statement which brings into agreement the cash balance per book and cash balance per bank. It is usually prepared monthly because the bank provides the depositor with the bank statement at the end of every month.

The source document for bank reconciliation is the bank statement coming from the bank.

A bank statement is a monthly report of the bank to the depositor showing the cash balance per bank at the beginning, the deposits acknowledged, the checks paid, other charges and credits and the daily cash balance per bank during the month. Actually, the bank statement is an exact copy of the depositor's ledger in the records of the bank.

**Forms of bank reconciliation**

1. Adjusted balance method - Under this method, the book balance and the bank balance are brought to a correct cash balance that must appear on the balance sheet.
2. Book to bank method - Under this method, the book balance is reconciled with the bank balance or the book balance is adjusted to equal the bank balance.
3. Bank to book method - Under this method, the bank balance is reconciled with the book balance or the bank balance is adjusted to equal the book balance.

**NOTE:** The above methods are not independent methods, they are inter-related. For a simpler computation, the suggested solution format below is based on the adjusted balance method.

**Solution guide for bank reconciliation**

<table>
<thead>
<tr>
<th>Unadjusted balance per book/ledger</th>
<th>xx</th>
<th>Unadjusted balance per bank</th>
<th>xx</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add: Credit Memos</td>
<td>xx</td>
<td>Add: Deposit in transit</td>
<td>xx</td>
</tr>
<tr>
<td>Less: Debit Memos</td>
<td>(xx)</td>
<td>Less: Outstanding checks</td>
<td>(xx)</td>
</tr>
<tr>
<td>+/- Errors</td>
<td>xx</td>
<td>+/- Errors</td>
<td>xx</td>
</tr>
<tr>
<td></td>
<td>(xx)</td>
<td></td>
<td>(xx)</td>
</tr>
<tr>
<td>Adjusted balance</td>
<td>xx</td>
<td>Adjusted balance</td>
<td>xx</td>
</tr>
</tbody>
</table>
Note: Errors are to be added or deducted by the party who committed the error based on its nature. The following is a guide on the treatment of the errors.

<table>
<thead>
<tr>
<th>Nature of the error</th>
<th>Understatement</th>
<th>Overstatement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Error on receipt (collection)</td>
<td>Added</td>
<td>Deducted</td>
</tr>
<tr>
<td>Error on disbursement (payment)</td>
<td>Deducted</td>
<td>Added</td>
</tr>
</tbody>
</table>

Based on the guide above, we can say the receipts or collections directly affect cash while disbursements or payments inversely affect cash.

**Proof of cash**

A proof of cash is an expanded reconciliation in that it includes proof of receipts and disbursements. This approach may be useful in discovering possible discrepancies in handling cash particularly when cash receipts have been recorded but have not been deposited.

In answering proof of cash, always bear in mind that it is just expanded bank reconciliation. You need the concept you absorbed from the previous topic in answering this topics questions. Follow these basis steps in answering proof of cash questions.

- **Step 1:** Analyze the beginning and ending column of the format as if it is bank reconciliation.
- **Step 2:** Analyze the middle columns based on the nature of the item.
DISCUSSION EXERCISES

STRAIGHT PROBLEMS

1. At December 31, 2019, SACRED WARRIOR CORP. reported the following as composition of its Cash and Cash Equivalents line item in its Statement of Financial Position:

   Cash on hand .......................... P300,000
   Cash in bank – URSA BANK ... 400,000
   Cash in bank – MOGUL BANK .. (30,000)
   Manager's check ................. 50,000
   Time deposit – URSA BANK .... 2,000,000
   Postage stamps ..................... 10,000
   Escrow deposit .................... 100,000
   Demand deposit – VOID BANK .. 300,000
   Payroll account – VOID BANK .. 500,000
   Treasury note ....................... 50,000
   Treasury shares ................... 90,000
   Treasury bills purchased 12/25/2019 maturing 4/1/2020 ... 120,000
   Cash in bank – DOTA BANK ... 300,000
   Cash in bank – MOBA BANK ... 150,000
   Money market placement due 6/2/2020 .. 100,000
   Money market placement due 2/5/2020 .. 80,000
   Revolving fund ..................... 40,000
   Contingency fund ................. 30,000
   Payroll fund ....................... 100,000
   Dividend fund ..................... 40,000
   Fund for acquisition of PPE ...... 200,000
   Unused credit line ............... 100,000
   Post-dated check, customer .... 60,000
   IOUs from employees ............. 90,000
   Foreign bank account - unrestricted (in equivalent pesos) .... 200,000
   Petty cash fund .................. 50,000
   Traveler’s check .................. 200,000

Additional information:
(a) Accounts payable of P16,400 was paid in January 2018. The payments on which a P1,400 cash discount has been taken were recorded on cash on hand in the December 31, 2019.
(b) Drawn against cash in URSA bank were check amounting to P40,000 dated December 26, 2019 still on one of the drawer of the accountant in the treasury department.
(c) Demand deposit to VOID bank is restricted for the company’s plant expansion next year.
(d) Cash in bank in DOTA BANK includes an informal compensating balance of P40,000 for long-term borrowing arrangement.
(e) Cash in bank in MOBA BANK includes restricted compensating balance of P50,000 for short-term borrowing arrangement.
(f) The petty cash fund included unreplenished December 2019 petty cash expense vouchers for P15,000.

REQUIREMENT(S): (1) Determine the amount of cash for the year ended 2019. (2) How much is to be reported as Cash and Cash equivalents in the Statement of Financial Position as of December 31, 2019?

2. The following information was provided by RAIGOR INC. in preparing its current month’s bank reconciliation:

   Balance per bank statement 9/30/2019 .......... 2,000,000
   Outstanding checks (with certified check of P100,000) ... 400,000
   Deposit placed in the bank's night depository on September 30 .. 600,000
   Bank service charge .................. 10,000
   Proceeds of bank loan not recorded by RAIGOR ........ 100,000
   Customer’s check charged by the bank due to lack of counter signature ... 20,000
   Amount erroneously credited by bank to RAIGOR's account .... 50,000
   A supplier check for P10,000 was incorrectly recorded by RAIGOR as 100,000
   Notes collected by the bank for RAIGOR ............. 150,000
   A customer check for P150,000 was incorrectly recorder by RAIGOR as 15,000
   NSF checks not recorded on books nor redeposited .... 25,000
   Check of RIGID CORP. charged by the bank to RAIGOR INC. .. 60,000
   Deposit of RAIGOR INC. credited by the bank to RAIGEE INC. .... 100,000
   Check issued by RAIGOR INC. charged by the bank to RAINOR CORP. .. 40,000

REQUIREMENT(S): (1) How much is the adjusted cash in bank balance for the month of September? (2) What is the unadjusted balance per book at the end of September?
3. MOGUL CORP provided the following bank reconciliation on August 31:

Balance per bank statement P1,500,000
Deposits outstanding 300,000
Checks outstanding (180,000)
Errors 70,000
Adjusted cash balance P1,690,000
Balance per ledger P1,575,000
Credit Memos 250,000
NSF Checks not recorded nor redeposited (90,000)
Bank service charge (5,000)
Errors (40,000)
Adjusted cash balance P1,690,000

Other Information pertaining to August:
- Book errors comprised an over-recording of customer check of P100,000 and over-recording of disbursement of P60,000.
- Bank error was actually an erroneous debit in the account of the company.

The following are data pertaining to September:

Receipts per ledger 1,600,000
Disbursements per ledger 700,000
Credit Memos 150,000
NSF Checks redeposited immediately 50,000
NSF Checks not recorded nor redeposited 40,000
Outstanding Checks 100,000
Deposit in Transit 280,000
Bank Service Charges 10,000
Error in recording customer check amounting to P100,000 as 10,000
Deposit of MOGAL CORP, credited to company's account 110,000
Check issued by MOGUL charged by the bank to MIGUL 60,000
Customer check amounting to 15,000 recorded by MOGUL as 150,000
Erroneous charge by the bank to MOGUL's account amounting to 40,000

REQUIREMENTS: Compute for the following:
(a) Adjusted cash in bank balance at the end of August
(b) Adjusted cash receipts of September
(c) Adjusted cash disbursements of September
(d) Adjusted cash in bank balance at the end of September
(e) Unadjusted balance per bank statement for September
(f) Unadjusted bank receipts of September
(g) Unadjusted bank disbursements of September

4. The following information was available for the current month’s cash in bank balance of BALANAR CORP:

Book debits in March P550,000
Bank credits in March 600,000
Book credits in March 250,000
Bank debits in March 300,000
Interest income on deposits in February recorded on March 10,000
Collection of note receivable by the bank of February recorded on March 150,000
Interest income on deposits for March 12,000
Note receivable collected on March 100,000
Bank service charge – February 20,000
Bank service charge – March 25,000
Deposit in transit – February 120,000
Outstanding checks – February 100,000

Summary of Errors
- Overstatement on book receipts – February 15,000
- Overstatement on book receipts – March 20,000
- Customer check for P50,000 recorded by BALANAR on February as 5,000
- Customer check for P100,000 recorded by BALANAR on March as 10,000
- Overstatement on book disbursements – February 30,000
- Overstatement on book disbursements – March 25,000
- Supplier check for P150,000 recorded by BALANAR on February as 15,000
- Supplier check for P90,000 recorded by BALANAR on February as 20,000
- Overstatement on bank receipts – February 30,000
- Overstatement on bank receipts – March 40,000

REQUIREMENTS: (1) Compute the deposit in transit for the month of March. (2) Compute the outstanding checks for the month of March.
MULTIPLE CHOICE (THEORIES)

1. S1: The basic requirement for cash and cash equivalent is for it to be restricted for use.
   S2: Money which is not legal tender can be part of cash.
   A. True, false
   B. False, true
   C. False, false
   D. True, true

2. At the end of the current year, an entity had various checks and papers in the safe. Which of the following should not be included in "cash" in the current year-end statement of financial position?
   A. US $20,000 cash.
   B. Past due promissory note issued in favor of the entity by the President.
   C. The entity's undelivered check payable to a supplier dated December 31 of the current year.
   D. Another entity's P150,000 check payable to the entity dated December 15 of the current year.

3. Which of the following is not a cash item?
   I. Demand deposit
   II. Customer post-dated checks
   III. Time deposit
   A. I and II
   B. II and III
   C. I and III

4. In relation to cash equivalents, determine whether the following statements are true or false:
   S1: Redeemable preference shares can never be part of cash equivalents since they are equity instruments.
   S2: If a debt instrument cannot be included as cash equivalent because it is acquired 4 months before its maturity date, it is still part of the current assets of the company.
   S3: Cash equivalents should be measured at maturity value, meaning face value plus interest.
   A. True, false, false
   B. False, true, false
   C. True, true, false

5. In replenishing a petty cash fund, which one of the following entries required?
   A. Debit Petty Cash, credit Cash in bank
   B. Debit individual expense accounts, credit Cash in bank
   C. Debit Petty Cash, credit individual expense accounts
   D. Debit Cash in bank, credit Petty Cash

6. In relation to cash and cash equivalent, which of the following statements are true or false?
   I. Checks are always presented as part of cash.
   II. Checks drawn which are post-dated should be reverted back to cash even if the checks are already delivered to the payees.
   III. An entity acquires an investment in debt securities on November 30, 20x1: The debt securities mature on January 31, 20x2. The debt securities qualify to be presented as part of cash equivalents on the entity's 20x1 financial statements.
   IV. A compensating balance that is legally restricted as to withdrawal cannot be included as part of cash and cash equivalents but can be presented as current asset.
   A. Statement I False
   B. Statement II True
   C. Statement III True
   D. Statement IV False

7. Which of the following may be used to compute for the adjusted balance of cash?
   A. Balance per bank statement + Deposits in transit – Outstanding checks - Erroneous credit to the account made by the bank
   B. Balance per bank statement + Deposits in transit – Outstanding checks + Erroneous credit to the account made by the bank
   C. Balance per bank statement + Deposits in transit – Outstanding checks - Erroneous debit to the account made by the bank
   D. Balance per bank statement + Deposits in transit – Outstanding checks, net of certified checks Erroneous credit to the account made by the bank
8. Which of the following statements in relation to bank reconciliation is true?
   A. The cash amount reported in the statement of financial position must be the balance reported in the bank statement.
   B. Credit memos will cause the cash balance per ledger to be higher than that reported by the bank, all other things being equal.
   C. Bank service charge will cause the cash balance per ledger to be higher than that reported by the bank, all other things being equal.
   D. Outstanding checks will cause the cash balance per ledger to be greater than the balance reported by the bank, all other things being equal.

9. The adjusting entries for a bank reconciliation
   A. Are taken from the “balance per bank” section only.
   B. May include a debit to office expense for bank service charge.
   C. May include a debit to accounts payable for an NSF customer check.
   D. May include a credit to accounts receivable for an NSF customer check.

10. When preparing a proof of cash, a credit memo from the previous month is
    A. extended to the book receipts column as an addition
    B. extended to the bank receipts column as an addition
    C. extended to the book receipts column as a deduction
    D. not extended in any of the book columns

--- END OF HANDOUTS ---