CHAPTER 6

CASH AND TEMPORARY INVESTMENT

1. If funds are readily available for the payment of current obligations and free contractual restrictions, they are classified as "cash" on the balance sheet. Therefore, coins, currency, checking account balances, checks, money orders, certified checks, and bank checks are all considered cash. Saving account balances are also considered cash, since banks rarely exercise their right to demand prior notice for withdrawals.
2. Money market funds and certificates of deposit (CDs) are classified as temporary investments, since they carry penalties for early withdrawals. However, money market funds that have checking account privileges without penalty are considered to be cash.
3. Postdated checks and IOUs are considered receivables, while stamps are office supplies. Travel advances to employees that must be repaid to the employer are receivables; others are a prepaid expense.
4. Short-term, highly liquid investments that are both readily convertible to cash and have original maturities of no more than 3 months are considered cash and referred to as cash equivalents.

5. The SEC recommends that checking account compensating balances held against short –term or long-term borrowings be stated separately in the current or non-current asset section respectively.
6. Restricted cash (such as cash set aside for plant expansion or retirement of debt) should be segregated from unrestricted cash on the balance sheet.
7. Overdrafts in checking accounts are considered current liabilities. They may be offset against positive balances of other accounts in the same bank, but not against those in other banks.
8. Typical transactions of petty cash funds are: establishment of the fund, usage of the fund, replenishment of the fund, and increasing the level of the fund. The Petty Cash T-account is touched only when the fund is established or increased.
9. Shortages or overages in petty cash are debited or credited to the Cash Short or over account. This account has a dual nature.
10. There are several reasons why the bank statement balance may not agree with the book balance. They include outstanding checks, deposits in transit, special charges and credits, and errors. The process of making these balances agree with each other is called a bank recon collation.
11. As a result of the bank reconciliation, journal entries must be made to update the books for items on the book side of the reconciliation. No entries are made for items on the bank side of the reconciliation.

12. Temporary investments consist of stocks and bonds that are both readily marketable and intended to be converted into cash within 1 year or the operating cycle. Brokers' fees are not expenses but are an addition to the cost of the investment.
13. If marketable debt securities are purchased above or below par. a discount or premium situation arises. The discount or premium is not amortized.
14. If a bond is purchased between interest dates, its price is increased by the accrued interest. This increase should be debited to interest revenue.

CHAPTER 7

RECEIVABLES

1. Receivables may be classified under two broad categories: trade and non-trade. Trade receivables are due from customers for goods and services and may be oral or written. Oral ones are accounts receivable; written ones are notes receivable. Non-trade receivables arise from other transactions, such as advances to employees and officers, dividends, and interest.
2. Cash discounts are reductions of the selling price for early payment. Under the gross method, the sale is recorded at the full selling price. If the customer pays early, the discount is recorded in the sales discount account, which is a contra to the sales account.
3. Under the net method, the sale is recorded at the net selling price. If the customer pays after the discount period, the extra amount goes to the revenue account, Sales Discounts Forfeited. The accounting profession prefers this method.
4. Because of the matching principle, the accounting for bad debts uses the allowance method. Its method requires the recognition of bad debts even before they take place, via an adjusting entry using estimates. This entry debits bad debts expense and credits

Allowance for Doubtful Accounts which acts as a contra to Accounts Receivable.

5. When we find out for certain that a customer will not pay, we "write off" his or her account by debiting the allowance account and crediting accounts receivable.
6. The estimate of bad debts expense may be based on either a percentage of the receivables (the aging method) or a percentage of credit sales. There is a critical, subtle difference between the two: The former method takes into account what already is in the allowance account; the latter method does not.
7. Assignment of receivables involves borrowing money from a bank or finance company, pledging the receivables as collateral, and paying an initial finance charge plus interest during the period the loan is outstanding.
8. Sales of receivables involve an outright transfer of the receivables to the finance company. Also known as factoring, this transfer may be done with or without recourse. In a with recourse situation, the seller is responsible for any bad debts; in a without recourse situation, the seller is not. In both cases the seller is responsible for sales returns and discounts.
9. When the transfer is made without recourse, it is treated as a sale for accounting purposes. If the transfer is made with recourse, however, three conditions need to be met to consider it a sale. If there are not met, the transfer, for accounting purposes, is not a sale but a borrowing.

10. Notes are written promises to pay a certain sum in the future. Interest –bearing notes have an explicitly stated rate of interest; non-interest-bearing notes have" hidden" interest.

11. If the rate stated in the note (the contract rate) is equal to the market rate, the note will be issued at its face value. If it is below the market rate, it will be issued at a discount; if it is above the market rate, it will be issued at a premium.

12. To determine the amount the note will be issued for, use the following formula:

    Loan = present value of principal + present value of interest payments

    For these present values, the interest tables should be looked up at the market rate, not the contract rate.

13-Discounts represent an addition to interest revenue: premiums represent a reduction. Both discounts and premium should be amortized via the effective interest method, unless the straight-line method produces results that are not materially different.

14-If a note is received for goods or services and it contains no stated interest or unreasonably low interest, the note should be recorded at the fair market value of the goods or services. Any difference between this value and the face of the note is considered "hidden" interest. If the fair market value is unknown, we must use an imputed rate. This is the rate the buyer would have to pay to obtain financing of a similar nature from other sources.

15-Notes receivable may be transferred to other parties by a process called discounting. The holder of the note transfers the note to a bank and in exchange receives the maturity value minus a discount. When the note natures, the banker collects the maturity value from the original maker of the note. Discounting may be done with or without recourse, and our with or without recourse, and our earlier discussion of these matters with regard to accounts receivable applies to notes receivable as well.