

8. CASH AND CASH EQUIVALENTS

8.1 Description

Cash and cash equivalents are defined as cash on hand, deposits in banks and short-term highly liquid instruments readily convertible to known amounts of cash and which are subject to insignificant risks of changes in value. Cash equivalents are temporary investments, usually in the form of time deposits in banks and other financial institutions with original maturity of three months or less from date of acquisition, which NPOs places very temporarily, while awaiting proper disbursement to fund approved projects.

Cash on hand accounts consist of currency, coins or negotiable instruments such as bank checks or postal money orders, in the custody of the cashier. This may consist of receipts of donations or collection of receivables or advances, in the form of cash or check, received awaiting deposit. This account should be treated as temporary account and should be zeroed-out regularly when the cash on hand items are deposited. Because of the vulnerability of cash to theft or misappropriation, the NPO should adopt a policy to minimize cash on hand and to deposit receipts or collections regularly or upon reaching a pre-defined amount.

Cash in bank accounts consist of deposits, either in savings or checking accounts, in banks which have been identified by the Board of Trustees as the NPO's depository banks. Grants and donations or funds from various funders or donors, or collections of receivables or advances should be deposited in specific bank accounts for easier identification and monitoring. The NPO should also identify a bank account from which disbursements can be withdrawn by check, and replenishment done through transfers from depository banks. Restricted funds should also be segregated from unrestricted funds.

8.2 Cash Transaction Cycle

- a. Receipt of cash or check from donors, funding agencies or collections of receivables or advances
- b. Deposit to bank accounts

- c. Disbursement for expenses or release of funds to agencies or beneficiaries for approved projects
- d. Liquidation by agencies or by beneficiaries and receipt of excess funding

Sample entries for different types of cash receipts and disbursements and other cash transactions:

1. Receipt of grant

Cash in bank – PDB SA # 110	100,000	
Grant from ABC		100,000

To record first remittance from ABC

2. Collection of donations

Cash on hand	1,000	
Donations		1,000

To record collection of donation

3. Collection of receivables

Cash on hand	500	
Receivable – resigned employee		500

To record collection of receivable from a resigned employee

4. Collection of excess from operational advances upon liquidation

Cash in bank – PDB CA # 111	1,000	
Transportation expense	350	
Meals expense	750	
Advances for liquidation - MPS		2,000

To record receipt of excess cash upon liquidation of advances by MPS for his visit to BBI project.

5. Receipt of excess funds from training project

Cash in bank – PDB SA # 110	1,900	
Training expense		8,100
Training fund		10,000

To record receipt of excess funds from training project.

6. Deposit of cash on hand for collections received late in the previous day

Cash in bank – PDB CA # 111	1,500	
Cash on hand		1,500

To close cash on hand balance of previous day and to record deposit in bank.

7. Sample semi-monthly expenses, such as payroll

Salaries and wages	45,000	
SSS and Medicare premiums expense	5,000	
Cash in bank – PDB CA # 111		52,000
Withholding tax payable		4,500
SSS and Medicare premiums payable		2,500
HDMF premiums payable		1,000

To record payroll charges for the first half of the month.

8. Transfer of funds from savings to current account

Cash in bank – PDB CA #111	47,000	
Cash in bank – PDB SA #110		47,000

To record transfer of funds from savings to current account with PDB.

9. Recording of interest income

Cash in bank – PDB SA #110	500	
Interest income		500

To record interest income for the month based on the bank reconciliation made.

10. Recognition of foreign exchange gain or loss

Cash in bank – PDB DSA #112		
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Foreign exchange gain

Important Notes:**Cash Disbursements**

Disbursements made by an NPO should be made in accordance with a budget or annual workplan. In addition, they should undergo a process involving the preparation of a voucher, properly supported by invoices, contracts and other documents, and approved for payment by authorized officers. The voucher should also indicate the accounts to be charged as specified in the budget or workplan. A check is then prepared and approved and signed by officers or signatories authorized in a resolution by the Board of Trustees.

Bank Reconciliation

Maintaining bank accounts entails monthly reconciliation of the NPO's book balance with the bank balance as reflected in the passbook in the case of a savings account, and in the bank statement in the case of the checking account. The bank sends monthly bank statements together with the paid checks. To reconcile, deposits and fund transfers and withdrawals in the bank statements should be compared with the deposit and withdrawal slips, debit and credit memos from the bank and entries in the cash receipts and cash disbursements books. Open items should be summarized in a bank reconciliation statement, and followed up in the following month. Long outstanding items should be the subject of further scrutiny.

8.3 Petty Cash Fund/ Revolving Fund

Small disbursements not paid by checks are paid using petty cash funds or revolving funds. The NPO should determine what day-to-day, small expenses are incurred, the amounts and frequency of incurrence to form a basis for establishing the so-called petty cash or revolving fund. The purpose is to enable the NPO to meet these operational expenses without going through the rigors of check preparation. The fund should be just enough, not too small that replenishment has to happen very often, but not too big that it allows such fund to lie idle for long enough to invite unauthorized borrowings by the custodian or anyone close to him.

Expenses should be authorized by the immediate superior of the requesting party and should be presented with the supporting documents in amounts not to exceed a certain pre-defined level. The fund to be established shall remain fixed in the books. It shall be replenished upon reaching a minimum level with the presentation of a summary of expenses submitted to the custodian for payment together with the supporting documents. The total amount of the expenses and the cash left with the custodian should always equal the amount of the petty cash/ revolving fund. Details of the expenses shall be recorded and the supporting documents shall be properly stamped "PAID" to prevent double payment.

1. Upon establishment of the fund

Petty cash fund	3,000	
Cash in bank – PDB CA #111		3,000

To record establishment of a petty cash fund.

2. Upon replenishment

(enumerate various specific expenses)	2,700	
Cash in bank – PDB CA #111		2,700

To record replenishment of petty cash fund and various expenses.

8.4 Foreign Currency Accounts and Foreign Exchange Transactions

Not all funds or donations or grants that an NPO receives are in local currency, in fact, because NPOs usually receive funding from foreign sources, these are usually in the form of foreign currencies – i.e., US Dollars, Euro, or Japanese Yen. This requires the opening and maintenance of foreign currency accounts in the NPO's depository banks. In addition, the NPO also has to comply with the provisions of IAS 21, "The Effects of Changes in Foreign Exchange Rates". This Standard is applied in accounting for transactions and balances in foreign currencies, in translating the results and financial position of foreign operations that can possibly be included in an NPO's financial statements by consolidation, proportionate consolidation or the equity method, and in translating an NPO's results and financial position into a presentation currency.

Presentation currency would mean the currency in which the financial statements are presented.

Definition of foreign currency transaction

A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity, or an NPO, buys or sells goods or services whose price is denominated in a foreign currency; or borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in foreign currency.

ILLUSTRATION

Missioni Foundation, an Italian group formed to assist agricultural research in Asia, grants Southern Philippines Research, Inc. (SPRI) US\$1,000 donation on April 4, 2005. Upon receipt of the donation, SPRI opens and maintains its dollar-denominated savings account with its bank, but has to record it in its books of accounts in Philippine Peso. And when it withdraws dollars or its money in foreign currency, and converts it into Philippine Peso, SPRI has to follow certain accounting rules emanating from IAS 21.

In the case cited above, a foreign currency transaction occurs when SPRI receives donation in US dollars, How to recognize it in its books shall be answered in the following discussion.

a. Initial Recognition

A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency (Philippine Peso) and the foreign currency (US Dollar) at the date of transaction (April 4, 2005).

Journal entries

April 4	Cash in bank – PDB DSA #112	56,000	
	Grants		56,000

To record US\$1,000 grant from Missioni assuming that the spot exchange rate is P56 to a US dollar.

b. Suppose SPRI withdraws US \$200 on April 6, 2005 on which the spot exchange rate is P55.80 to a US dollar, it will make the following entry:

April 6	Cash in bank – PDB SA #110	11,160	
	Cash in bank – PDB DSA #113		11,160

To record withdrawal of US \$200 at P55.80 exchange rate.

- c. Supposing SPRI allots P8,000 for a research project and spends the Peso balance for operations, it makes another entry:

April 7	Project Expense	8,000	
	Administrative Expense	3,160	
	Cash in bank – PDB SA #110		11,160

To record project and administrative expenses.

- d. Reporting at balance sheet date

There is no problem with the dollar depository bank at month-end, it will reflect in the SPRI's passbook the dollar value of its deposit, which is US \$800. But in its books of accounts and financial statements, SPRI should state foreign currency monetary items, which include cash, at the closing rate and recognize a foreign exchange gain or loss for the exchange difference between the initial recognition rate and the closing rate.

Let us say, the closing rate is P56.10 as of April 30, 2005, SPRI shall translate its US \$800, which is equivalent to P44,880, SPRI compares it with the general ledger balance of its dollar-denominated savings account and recognizes a difference of P40 as foreign exchange gain.

The following entry should be made:

April 30	Cash in bank – PDB DSA #113	40	
	Unrealized foreign exchange gain		40

To recognize unrealized foreign exchange gain.

Thus, the initial financial statements should look like the following:

SPRI	
Balance Sheet	
April 30, 2005	
Current Assets	
Cash and cash equivalents	<u>P44,880</u>
Net Asset	<u>P44,880</u>

SPRI	
Statement of Activities	
For the Month Ended April 30, 2005	
Revenues	
Grants	P56,000
Unrealized Foreign Exchange Gain	40
Expenses	
Project Expenses	(8,000)
Administrative Expenses	<u>(3,160)</u>
Excess of Revenue over Expenses	<u>P44,880</u>