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Cash and Cash Equivalents (CCE) Definition: Types and Examples

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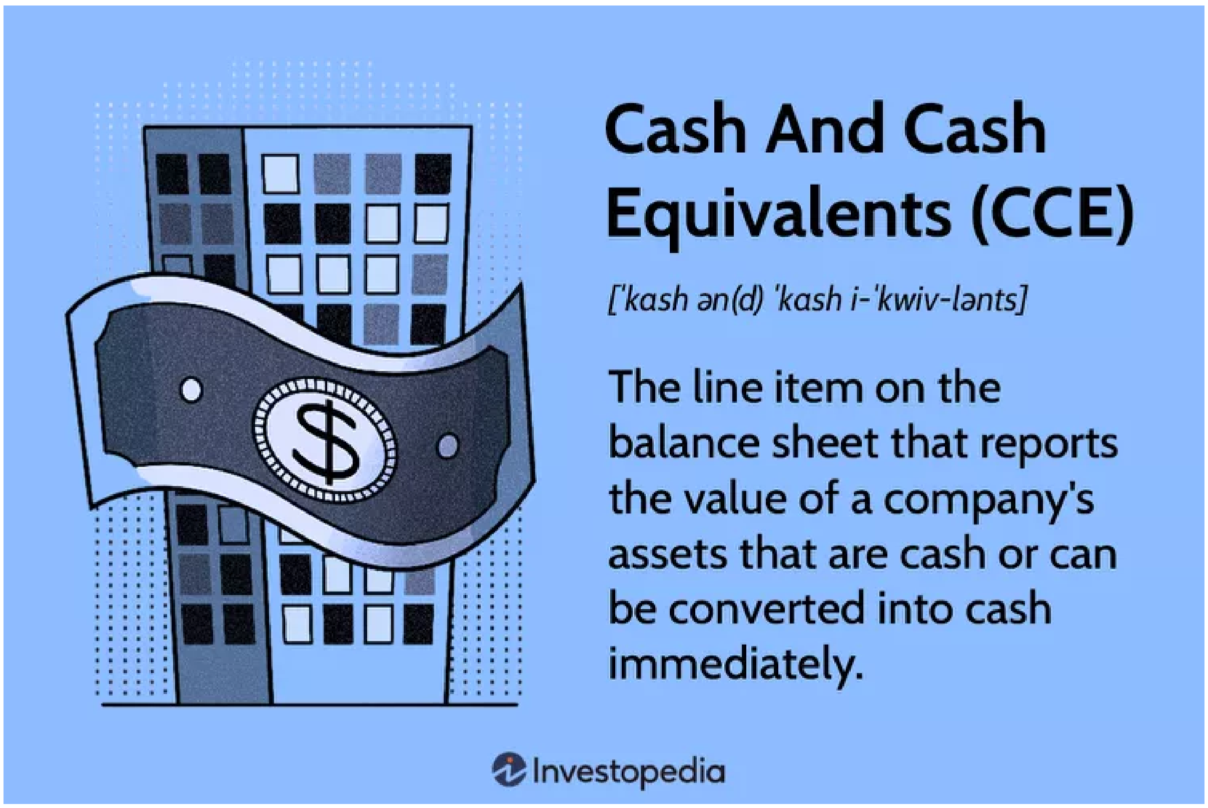

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What Are Cash and Cash Equivalents (CCE)?

Cash and cash equivalents refers to the line item on the balance sheet that reports the value of a company's assets that are cash or can be converted into cash immediately. Cash equivalents include bank accounts and marketable securities, which are debt securities with maturities of less than 90 days. However, oftentimes cash equivalents do not include equity or stock holdings because they can fluctuate in value.

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KEY TAKEAWAYS

- Cash and cash equivalents refers to the line item on the balance sheet that reports the value of a company's assets that are cash or can be converted into cash immediately.
- Cash equivalents include bank accounts and marketable securities such as commercial paper and short-term government bonds.
- Cash equivalents should have maturities of three months or less.
- Cash equivalents must also be able to be liquidated to cash; for this reason, cash equivalents often have active markets.
- A company carries cash and cash equivalents to pay its short-term bills but to also preserve capital for long-term capital deployment.

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Cash and Cash Equivalents

Understanding Cash and Cash Equivalents (CCE)

Cash and cash equivalents are a group of assets owned by a company. For simplicity, the total value of cash on hand includes items with a similar nature to cash. If a company has cash or cash equivalents, the aggregate of these assets is always shown on the top line of the balance sheet. This is because cash

FAST FACT

Companies with a healthy amount of cash and cash equivalents can reflect positively in their ability to meet their short-term debt obligations.

Types of Cash and Cash Equivalents

Cash and cash equivalents help companies with their working capital needs since these liquid assets are used to pay off current liabilities, which are short-term debts and bills.

Cash

Cash is money in the form of currency, which includes all bills, coins, and currency notes. A demand deposit is a type of account from which funds may be withdrawn at any time without having to notify the institution. Examples of demand deposit accounts include checking accounts and savings accounts. All demand account balances as of the date of the financial statements are included in cash totals.

Foreign Currency

currency for financial reporting purposes. The conversion should provide results comparable to those that would have occurred if the business had completed operations using only one currency. Translation losses from the devaluation of foreign currency are not reported with cash and cash equivalents. These losses are reported in the financial reporting account called "accumulated other comprehensive income." [1]

Cash Equivalent

Cash equivalents are investments that can readily be converted into cash. The investment must be short term, usually with a maximum investment duration of three months or less. If an investment matures in more than three months, it should be classified in the account named "other investments." Cash equivalents should be highly liquid and easily sold on the market. The buyers of these investments should be easily accessible.

The dollar amounts of cash equivalents must be known. Therefore, all cash equivalents must have a known market price and should not be subject to price fluctuations. The value of the cash equivalents must not be expected to change significantly before redemption or maturity. Examples of cash equivalents include:

- **Marketable Securities.** This broad term covers any investment security that can quickly be converted to cash in a short amount of time. Many of the examples below can also be referred to as a marketable security, and companies often lump these investments together on their balance sheet.
- **Treasury Bills.** These debt instruments are issued by the United States government and often have a maturity date of one year or less.
- **Other Short-Term Government Bonds.** These debt instruments may be issued by any government entity (city, state, or Federal). The creditworthiness of the government agency must be considered when evaluating the risk of the bond.
- **Banker's Acceptance.** This is an agreement where the bank has agreed to guarantee a future agreement between two parties. This instrument is a

Commercial paper has maturity up to nine months (270 days). The interest rate on commercial paper will vary based on the creditworthiness of the issuing corporation.

- Money Market Account. This interest-bearing account is similar to a savings account; however, they often require larger minimum deposits and have some minor restrictions to the account.
- **Certificates of Deposits.** CD's may be considered a cash equivalent depending on the maturity date.
- **Preferred Shares of Equity.** This may be considered a cash equivalent if they are purchased shortly before the redemption date and not expected to experience material fluctuation in value.

FAST FACT

A company can have too much cash or cash equivalents on hand, though. It may be inefficient to sit on these resources instead of deploying them for company growth or rewarding investors with dividends.

Exclusion From Cash and Cash Equivalents

There are some exceptions to short-term assets and current assets being classified as cash and cash equivalents.

Credit Collateral

Exceptions can exist for short-term debt instruments such as Treasury-bills if they're being used as collateral for an outstanding loan or line of credit. Restricted T-bills must be reported separately. In other words, there can be no restrictions on converting any of the securities listed as cash and cash equivalents.

Inventory

not guaranteed, meaning there's no certainty in the amount that'll be received for liquidating the inventory.

Unbreakable Certificate of Deposits

A grey area of cash equivalents relates to certificate of deposits for terms longer than 3 months that can not be broken. Oftentimes, financial institutions will allow the CD holder to break their financial product in exchange for a forfeiture of interest (i.e. the last six months of interest is foregone). If a financial institution does not allow this option, the CD should not be treated as a cash equivalent. This is especially true for longer-term products such as five-year CDs that must be held to maturity.

Prepaid Assets

A company may report prepaid assets as part of its current asset section. These prepaid assets may be refundable. However, because there is risk that a refund cannot be processed timely or there may be only a partial return of funds, prepaid assets are not considered cash equivalents.

Accounts Receivable

Because of the uncertainty regarding client creditworthiness, outstanding account receivable balances are not cash equivalents even if the invoice is due or shortly to be due. Even if a debt is ready for collection, there is no guarantee the client will be able to pay. In addition, the company may not have preferential positioning in bankruptcy or liquidation proceedings. Therefore, money owed from clients is not the same as cash equivalents.

Cash vs. Cash Equivalents

Although the balance sheet account groups cash and cash equivalents together, there are a few notable differences between the two types of accounts. Cash is obviously direct ownership of money, while cash equivalents represent ownership of a financial instrument that often ties to a claim to cash.

often insured up to $250,000 by the FDIC. However, money market mutual funds are not federally insured. Debt instruments, whether issued by a government or corporation, is tied to the health of that entity with no guarantee the entity may survive the term of the cash equivalent.

Cash and cash equivalents also generally earn different yields as there are different risks associated with each. Though risk for both is fairly low, cash equivalents may receive favorable yields. In addition, some money market funds may be tax-exempt or be held in tax-favorable accounts. Meanwhile, cash often receives lower rates of interest in deposit accounts.

> **Important:** Because cryptocurrencies are not legal tender and not backed by governments or legal entities, U.S. GAAP does not treat cryptocurrency as cash, foreign currency, or cash equivalents. [2]

Purpose of Cash and Cash Equivalents

Companies carry cash and cash equivalents for a variety of business reasons. A company may want to have cash and cash equivalents on hand to:

- **Pay current debts.** Companies must use cash and cash equivalents to pay invoices and current portions of long-term debts as they come due. Instead of needing to liquidate long-term assets, payment is made with the most liquid assets.
- **Save for future capital investments.** Companies may have a long-term plan for growth or development, and that plan may require a substantial amount of capital. Risk-averse companies or businesses that may be looking to scale in a year or two may not be willing to invest their funds in riskier products. Instead, holding cash and cash equivalents is often a safe place for companies to park funds they'll need in the future.
- **Plan for emergencies.** On the same note, cash equivalents are the closest instruments to cash. Whether a company is holding cash or cash

- **Meet financial covenants.** A company may be required to hold a certain amount of highly liquid assets as part of a debt covenant. That covenant may not stipulate what the financial product has to be or carry any restrictions on it. For example, a loan may require a company hold a certain amount of cash or cash equivalents.

Real-World Example of Cash and Cash Equivalents

In its third quarter 2022 condensed consolidated balance sheet, Apple Inc. reported $27.502 billion of cash and cash equivalents. On September 25, 2021, Apple Inc. had reported $34.94 billion of cash and cash equivalents. [3]

Apple Inc. Q3 2022 Balance Sheet

Apple Inc. Q3 2022 Balance Sheet (Select Accounts).

In Note 3 to its financial statements, Apple provides a substantial amount of information regarding what comprises this cash and cash equivalent balance. Apple classifies its broad assortment of financial instruments as cash, Level 1 instruments, or Level 2 instruments (based on how the item is valued). [3]

Apple Inc, Q3 2022 Cash Equivalents

In the table above, the fifth column represents the value Apple assigned as cash and cash equivalents. The company owns cash, money market funds, U.S. Treasury securities. U.S. agency securities, certificate of deposit and time deposits, commercial paper, and corporate debt securities. [3]

What Is the Difference Between Cash and Cash Equivalents?

Cash is the direct ownership of a government-issued currency. This may take the form of physical cash (bills and coins) or digital cash (i.e. bank account balances).

Cash equivalents are short-term investments that can be easily liquidate, carry low risk of loss, and have active marketplaces to ensure quick transacting. These instruments can easily be converted to cash but are classified differently because they are not actual claims of ownership of cash.

Are Cash Equivalents Better Than Cash?

Cash equivalents have certain benefits over cash that make them better for some investors. However, both types of financial instruments are very similar and yield similarly low yields. The difference between cash and cash equivalents is minimal.

Why Do Companies Hold Cash Equivalents?

Cash equivalents often have slightly greater yields than cash. Even buying one-month Treasury bills may yield higher rates than what a company may get on their savings account. Cash yields also allows a company to strategically hold low-risk investments for future use while still attempting to preserve purchasing power better than holding cash directly.

What Makes a Financial Instrument a Cash Equivalent?

Financial instruments are defined as cash equivalents if they are highly liquid products that have active marketplaces, are without liquidation restrictions, and are easily convertible to cash. A company should be able to sell or liquidate

The Bottom Line

Cash and cash equivalents are the most liquid current assets on a company's balance sheet. The assortment of financial products that comprise the balance of this classification usually have maturities of three months or less, are easily convertible to cash, and must not be tied to restrictions that limit their liquidity. Companies often hold cash and cash equivalents to pay short-term debt and hold capital in secure places for future use.

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