

Problems

St. Jude Medical, Inc. is a publicly owned corporation engaged in the manufacture of heart valves and other medical products. In recent years, the company has accumulated large amounts of cash and cash equivalents as a result of profitable operations. A recent annual report showed that cash and cash equivalents amounting to more than 50% of the company's total assets. During the period that these large holdings of cash and cash equivalents have accumulated, the company has paid no cash dividends. Some financial analysts thought St. Jude was holding too much cash.

PROBLEM 7.1 Cash Management

Instructions

- Why would anyone think that a company was holding "too much cash"?
- What can a corporation do to efficiently utilize cash balances in excess of the amounts needed for current operations?
- Evaluate St. Jude's policies of accumulating liquid resources instead of paying dividends from the perspectives of:
 - The company's creditors.
 - The company's stockholders.

Explain how each of the following items is reported in a complete set of financial statements, including the accompanying notes. (In one or more cases, the item may not appear in the financial statements.) The answer to the first item is provided below as an example.

- Cash equivalents.
- Cash in a special fund being accumulated for the purpose of retiring a specific long-term liability.
- Compensating balances.
- The amount by which the current market value of securities classified as available for sale exceeds their cost.
- The allowance for doubtful accounts receivable.
- The accounts receivable turnover rate.
- Realized gains and losses on investments sold during the period.
- Proceeds from converting cash equivalents into cash.
- Proceeds from converting investments in marketable securities into cash.

Example: a. Cash equivalents normally are *not* shown separately in financial statements. Rather, they are combined with other types of cash and reported under the caption "Cash and Cash Equivalents." A note to the statements often shows the "breakdown" of this asset category.

The cash transactions and cash balances of Norfleet Farm for July were as follows:

- The ledger account for Cash showed a balance at July 31 of \$16,766.95.
- The July bank statement showed a closing balance of \$18,928.12.
- The cash received on July 31 amounted to \$4,017.15. It was left at the bank in the night depository chute after banking hours on July 31 and therefore was not recorded by the bank on the July statement.
- Also included with the July bank statement was a debit memorandum from the bank for \$7.65 representing service charges for July.
- A credit memorandum enclosed with the July bank statement indicated that a non-interest-bearing note receivable for \$4,545 from Rene Manes, left with the bank for collection, had been collected and the proceeds credited to the account of Norfleet Farm.
- Comparison of the paid checks returned by the bank with the entries in the accounting records revealed that check no. 821 for \$835.02, issued July 15 in payment for office equipment, had been erroneously entered in Norfleet's records as \$853.02.
- Examination of the paid checks also revealed that three checks, all issued in July, had not yet been paid by the bank: no. 811 for \$861.12; no. 814 for \$640.80; no. 823 for \$301.05.
- Included with the July bank statement was a \$180 check drawn by Howard Williams, a customer of Norfleet Farm. This check was marked "NSF." It had been included in the deposit of July 27 but had been charged back against the company's account on July 31.

PROBLEM 7.2 Reporting Financial Assets

PROBLEM 7.3 Bank Reconciliation



Northwest Farms		
Bank Reconciliation		
July 31, 2012		
Cash balance per bank statement		18928.12
Add: Deposit in transit		407.15
Deduct: Outstanding checks: 811	861.12	
814	640.80	
823	301.05	1802.97
Adjusted Cash Balance		1676.95 21147.30
Cash balance per books		1676.95
Add: 1676.95 Collection of Note Receivable:	4545	
Check Error on #821 (853.02-835.02)	18	4563
Deduct: Service Charge	7.65	
NSF Check	180.00	187.65
Adjusted Cash Balance		21147.30

July 31 Cash 4563
 Notes Receivable 4545
 Office Equipment 18

 Bank Service Charge Expense 7.65
 A/R 180.00
 Cash 187.65