

Statutory Issue Paper No. 2

Definition of Cash

STATUS

Finalized March 16, 1998

Original SSAP: SSAP No. 2; Current Authoritative Guidance: SSAP No. 2R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory guidance limits the classification of cash to include only *“a medium of exchange that a bank will accept for deposit and allow an immediate credit to the depositor’s account.”* The statutory guidance also allows *“temporary investments in the form of saving accounts and nonnegotiable certificates of deposit in qualified banks and trust companies”* to be classified as cash. Nonnegotiable certificates of deposit are instruments whose title may only be transferred upon the agreement of the affected parties to the terms and conditions of the transfer and not upon endorsement and delivery or delivery alone.

2. Additionally, current statutory practice allows reporting of negative cash as a negative asset. This treatment is consistent with the conservatism concept discussed in the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

Cash Definition

3. Cash constitutes a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor’s account. Also classified as cash for financial statement purposes, although not falling within the above definition of cash, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates in one year or less from the acquisition date and cash equivalents. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition.

Treatment of Negative Cash Balances

4. If a reporting entity has multiple cash accounts, the net amount of all such accounts shall be reported jointly. Cash accounts with positive balances shall not be reported separately from cash accounts with negative balances. If in the aggregate, the reporting entity has a net negative cash balance, this amount shall be reported as such in the annual statement and shall not be recorded as a liability.

DISCUSSION

5. As stated in the Statement of Concepts, *“the cornerstone of solvency measurement is financial reporting. Therefore, the regulator’s ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders.”* Additionally, it states *“the ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due.”* The definition of cash is consistent with the Statement of Concepts. Those instruments not included in the definition of cash (e.g., commercial paper and overnight repurchase agreements in excess of 3 months) shall be shown separately as short-term investments.

6. Treating all certificates of deposit with maturity dates in one year or less from the financial statement date as cash is a change from current statutory accounting. This change was made to address inconsistencies in the guidance between the Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies and Life and Accident and Health Insurance Companies (P&C and Life/A&H Accounting Practices and Procedures Manuals) and the *Purposes and Procedures Manual of the NAIC Securities Valuation Office* (SVO Purposes and Procedures). The P&C and Life/A&H Accounting Practices and Procedures Manuals require all nonnegotiable certificates of deposit to be classified as cash and negotiable certificates of deposit to be classified as short-term investments or bonds depending on the length to maturity at acquisition. The SVO Purposes and Procedures requires both negotiable and nonnegotiable certificates of deposit to be submitted to the SVO and valued under the general provisions for valuing bonds.

7. The treatment of recording negative cash as a negative asset in the statutory balance sheet follows the concept of conservatism as many regulatory limitations are calculated based upon total admitted assets.

Drafting Notes/Comments

- Funds classified as cash which are not immediately available for the benefit of policyholders (i.e., restricted cash, trust accounts, etc.) is addressed in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*.
- Treatment of drafts issued and drafts honored will be addressed in a separate issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

8. Existing statutory accounting guidance specifically addresses assets qualifying for treatment and classification as cash. Statutory accounting classifies certain assets as being either cash, short-term or long-term investments. The P&C Accounting Practices and Procedures Manual defines cash as follows:

The asset must be a medium of exchange that a bank will accept for deposit and allow an immediate credit to the depositor's account. Also classified for financial statement purposes, although not falling within the above description of cash, are temporary investments in the form of saving accounts and nonnegotiable certificates of deposit in qualified banks and trust companies.

There is a similar definition of cash in the Life/A&H Accounting Practices and Procedures Manual.

9. Section 2(C)(7) of the SVO Purposes and Procedures indicates the following requirements for certificates of deposit: "Certificates of Deposit (negotiable and non-negotiable) will be considered under the general provisions of Section 2(B)."

Generally Accepted Accounting Principles

10. GAAP adds a "cash equivalent" category for instruments classified as cash. GAAP literature defines a cash equivalent to be short-term, highly liquid investments that are readily convertible to known amounts of cash and are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies, Chapter 5
- Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, Chapter 5

- Accounting Practices and Procedures (EX4) Task Force Minutes
- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*, Section 2
- NAIC Annual Statement Instructions

Generally Accepted Accounting Principles

- *FASB Statement No. 95, Statement of Cash Flows*

State Regulations

- North Carolina Insurance Department Directive 92-D-2

Other Sources of Information

- Draft discussion material from previous Property/Casualty codification projects, Chapter 5.