FINANCIAL MANAGEMENT

Assignment

Sir Naveed Azeem

SHARJEEL SHAH

ID # 16682

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<u>Current assets generally fall into five categories, sorted from most to least liquid:</u>

Cash and Cash Equivalents: Short-term commitments that is easily convertible into known cash amounts. Examples include currency, checking account balances, treasury bills, and short-term government bonds (if the maturity date is three months or less).

IAS 7 prescribes how to present information in a statement of cash flows about how an entity's cash and cash equivalents changed during the period. Cash comprises cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

The statement classifies cash flows during a period into cash flows from operating, investing and financing activities:

- Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. An entity reports cash flows from operating activities using either:
    - the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
    - the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments and items of income or expense associated with investing or financing cash flows.

Accounts Receivable

Included under this category are: accounts and notes receivable, receivables from affiliate companies, and officer and employee receivables. The term "accounts receivable" represents amounts due from customers arising from transactions in the ordinary course of business. Allowances due to expected lack of collectability and any amounts discounted or pledged, however, should be disclosed clearly.

According to **IAS 32** Financial Instruments: Recognition, trade receivables are classified as a financial asset, namely an asset that is a contractual right to receive cash or another financial asset from another entity. In terms of **IAS 39**, such financial assets are measured at amortized cost as they fall in the category 'loans and receivables'.

IFRS 9 states that a financial asset shall be measured at fair value unless it is measured at amortized cost in accordance, which reads as follows:

A financial asset shall be measured at amortized cost if both of the following conditions are met:

The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.

The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Interest is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time.

Inventory and Supplies: Raw materials, units in production, and finished goods. Examples include steel, unassembled vehicles, and finished cars.

IAS 2 provides guidance for determining the cost of inventories and the subsequent recognition of the cost as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. Inventories are measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
The cost of inventories includes all costs of purchase, costs of conversion (direct labor and production overhead) and other costs incurred in bringing the inventories to their present location and condition. The cost of inventories is assigned by:

- Specific identification of cost for items of inventory that are not ordinarily interchangeable; and

- The first-in, first-out or weighted average cost formula for items that are ordinarily interchangeable (generally large quantities of individually insignificant items).

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs.

Prepaid Expenses: These are assets created by the prepayment of cash or incurrence of a liability. Prepaid expenses expire and become expenses with the passage of time, use, or events, for example: prepaid rent, prepaid insurance and deferred taxes.

Current Liabilities – A Liability, according to IAS 1, should be classified as a "current liability" when:

- It is expected to be settled in the normal course of business within the entity's operating cycle; or
- It is due to be settled within twelve months of the date of the statement of financial position; or
- It is held primarily for the purpose of being traded; or
- The entity does not have an unconditional right to defer settlement beyond twelve months

Otherwise, they should be classified as noncurrent liabilities.

Current liabilities also include:

1. Obligations arising from the acquisition of goods and services entering into the entity's normal operating cycle, for example:

- Accounts Payable
- Short-term Notes Payable
- Wages Payable
- Taxes Payable
- Miscellaneous Payable

2. Collections of money in advance for the future delivery of goods or performance of services, for example:

- Rent Received in Advance
- Unearned Subscription Revenues

3. Other obligations maturing within the current operating cycle, for example:

- Current Maturity of Bonds
- Long-term Notes

As these are happened to receivable and inventories on the asset' side, certain liabilities (on the liability's side) which is form part of the working capital used in the normal operating cycle of the business, are to be classified as current liabilities EVEN if they are due to be settled after more than twelve months from the date of the statement of financial position, fall under these criteria are:

- Trade Payables
- Accruals for Operating Costs

Other current liabilities which are not settled as part of the operating cycle, but which are due for settlement within twelve months of the date of the statement of financial position, such as dividends payable and the current portion of long-term debt, should also be classified as current liabilities. However, interest-bearing liabilities that provide the financing for working capital on a long-term basis and are not scheduled for settlement within twelve months should not be classified as current liabilities.

Note: obligations that are due on demand or are callable at any time by the lender are classified as current regardless of the present intent of the entity or of the lender concerning early demand for repayment.

Important Notes on Classifying Liabilities

IAS 1 provides another exception to the general rule that a liability due to be repaid within twelve months of the date of the statement of financial position should be classified as a current liability. If the original term was for a period longer than twelve months and the entity intended to refinance the obligation on a long-term basis prior to the date of the statement of financial position, and that intention is supported by an agreement to refinance, or to reschedule payments, which is completed before the financial statements are approved, then the debt is to be reclassified as noncurrent as of the date of the statement of financial position.

Employee's Benefit:

IAS 19 prescribes the accounting for all types of employee benefits except share-based payment, to which IFRS 2 applies. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment. IAS 19 requires an entity to recognize:

- A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- An expense when the entity consumes the economic benefit arising from the service provided by an employee in exchange for employee benefits.

Short-term employee benefits (to be settled within 12 months, other than termination benefits)

These are recognized when the employee has rendered the service and are measured at the undiscounted amount of benefits expected to be paid in exchange for that service.

Post-employment benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment

Plans providing these benefits are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions:

- A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Under IAS 19, when an employee has rendered service to an entity during a period, the entity recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense) and as an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset.

A defined benefit plan is any post-employment benefit plan other than a defined contribution plan. Under IAS 19, an entity uses an actuarial technique (the projected unit credit method) to estimate the ultimate cost to the entity of the benefits that employees have earned in return for their service in the current and prior periods; discounts that benefit in order to determine the present value of the defined benefit obligation and the current service cost; deducts the fair value of any plan assets from the present value of the defined benefit obligation; determines the amount of the deficit or surplus; and determines the amount to be recognized in profit and loss and other comprehensive income in the current period. Those measurements are updated each period.

Other long-term benefits

These are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits. Measurement is similar to defined benefit plans.

Termination benefits

Termination benefits are employee benefits provided in exchange for the termination of an employee's employment. An entity recognizes a liability and expense for termination benefits at the earlier of the following dates:

When the entity can no longer withdraw the offer of those benefits; and

When the entity recognizes costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

Income Taxes:

IAS 12 prescribes the accounting treatment for income taxes. Income taxes include all domestic and foreign taxes that are based on taxable profits.

Current tax for current and prior periods is, to the extent that it is unpaid, recognized as a liability. Overpayment of current tax is recognized as an asset. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

IAS 12 requires an entity to recognize a deferred tax liability or (subject to specified conditions) a deferred tax asset for all temporary differences, with some exceptions. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

A deferred tax liability arises if an entity will pay tax if it recovers the carrying amount of another asset or liability. A deferred tax asset arises if an entity, will pay less tax if it recovers the carrying amount of another asset or liability; or has unused tax losses or unused tax credits.

IAS 1 Presentation of Financial Statements

Overview: Sets out the overall framework for presenting general purpose financial statements, including guidelines for their structure and the minimum content.

A complete set of financial statements comprises:

- A statement of financial position
- A statement of profit or loss and other comprehensive income
- A statement of changes in equity
- A statement of cash flows
- Notes

In the statement of financial position, assets and liabilities are required to be classified as <u>current</u> or non-current, unless presenting them in order of liquidity provides reliable and more relevant information.

IAS 2 Inventories

Overview: Prescribes the accounting for inventories.

Initial measurement of inventory: Inventories are stated at the lower of cost and net realisable value (NRV). Costs include purchase cost, conversion cost (materials, labour and overheads), and other costs to bring inventory to its present location and condition, but not foreign exchange differences (see IAS 21). For inventory that is not interchangeable, specific costs are attributed to the specific individual items of inventory. For interchangeable items, cost is determined on either a First In First Out (FIFO) or weighted average basis. Last In First Out (LIFO) is not permitted.

Cost of goods sold: When inventory is sold, the carrying amount is recognised as an expense in the period in which the related revenue is recognised.

Impairment: Write-downs to NRV are recognised as an expense in the period the loss occurs. Reversals arising from an increase in NRV are recognised as a reduction of the inventory expense in the period in which they occur.

IAS 7 Statement of Cash Flows

Overview: Requires a statement of cash flows to present information about changes in cash and cash equivalents, classified as operating, investing and financing activities.

Cash and cash equivalents: Cash equivalents include investments that are short-term (less than three months from date of acquisition), readily convertible to a known amount of cash, and subject to an insignificant risk of changes in value.

Operating, investing and financing cash flows: Operating activities are the principal revenue producing activities of the entity and other activities that are not investing or financing activities. Operating cash flows are reported using either the direct (recommended) or the indirect method. Cash flows from taxes on income are classified as operating unless they can be specifically identified with financing or investing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Aggregate cash flows from obtaining or losing control of subsidiaries are presented separately and classified as investing activities. Investing and financing transactions that do not require the use of cash are excluded from the statement of cash flows, but need to be disclosed.

IAS 7 requires an entity to disclose the components of cash and cash equivalents and to present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.

IAS 32 Financial Instruments: Presentation

Overview: Prescribes the accounting for classifying and presenting financial instruments as liabilities or equity and for offsetting financial assets and liabilities.

Classification: Classification of an instrument is based on its substance rather than its form and the assessment is made at the time of issue and is not altered subsequently.

An equity instrument is an instrument that evidences a residual interest in the assets of the entity after deducting all of its liabilities.

A financial liability is an instrument that obligates an entity to deliver cash or another financial asset, or the holder has a right to demand cash or another financial asset. Examples are bank loans and trade payables, but also mandatorily redeemable preference shares.

Puttable instruments and instruments that impose on the entity an obligation to deliver a pro-rata share of net assets only on liquidation that are subordinate to all other classes of instruments and meet additional criteria, are classified as equity instruments even though they would otherwise meet the definition of a liability.

An issuer classifies separately the debt and equity components of a single compound instrument such as convertible debt, at the time of issue.

The cost of treasury shares is deducted from equity. Resales of treasury shares are accounted for as equity issuances.

Financial assets and liabilities can only be offset, and the net amount reported, when an entity has a legally enforceable right to set off the amounts and intends either to settle on a net basis or simultaneously.

Interest, dividends, gains and losses relating to an instrument classified as a liability are reported as income or expense.

IFRS 3 Business Combinations

Overview: An acquirer of a business recognises the assets acquired and liabilities assumed at their acquisitiondate fair values and discloses information that enables users to evaluate the nature and financial effects of the acquisition.

Recognition of assets and liabilities: The acquisition method is used for all business combinations. The acquirer recognises the identifiable assets acquired, the liabilities assumed and any noncontrolling interest (NCI) in the acquiree. Intangible assets, including in-process research and development, acquired in a business combination are recognised separately from goodwill if they arise as a result of contractual or legal rights, or if they are separable from the business. In these circumstances the recognition criteria are always considered to be satisfied (see also IAS 38).

Measurement: Assets and liabilities are measured at their fair values (with a limited number of specified exceptions) at the date the entity obtains control of the acquiree. If the initial accounting for a business combination can be determined only provisionally by the end of the first reporting period, the combination is accounted for using provisional values. Adjustments to provisional values relating to facts and circumstances that existed at the acquisition date are permitted within one year.

The acquirer can elect to measure the components of NCI in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in liquidation either at fair value or at the NCI's proportionate share of the net assets.

IFRS 7 Financial Instruments: Disclosures

Overview: Prescribes disclosures to help the primary users of the financial statements evaluate the significance of financial instruments to the entity, the nature and extent of their risks and how the entity manages those risks. It requires disclosure of information about the significance of financial instruments to an entity's financial position and performance, including its accounting policies and application of hedge accounting.

Disclosure: Entities must disclose information about financial assets and financial liabilities by category; special disclosures when the fair value option or fair value through OCI option is used; reclassifications; offsetting of financial assets and liabilities; collateral; allowance accounts; compound financial instruments with embedded derivatives; defaults and breaches and transfers of financial assets.

IFRS 9 Financial Instruments

Overview: Sets out requirements for recognition and measurement of financial instruments, including impairment, derecognition and general hedge accounting.

Initial measurement: All financial instruments are initially measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs.

Classification of financial assets: Financial assets with contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the contractual cash flows test) are classified according to the objective of the business model of the entity.

If the objective is to hold the financial assets to collect the contractual cash flows, they are measured at amortised cost, unless the entity applies the fair value option. Interest revenue is calculated by applying the effective interest rate to the amortised cost (which is the gross carrying amount minus any loss allowance) for credit-impaired financial assets while for all other instruments, it is calculated based on the gross carrying amount.

Financial liabilities: Financial liabilities held for trading are measured at FVTPL. All other financial liabilities are measured at amortised cost unless the fair value option is applied. The fair value option can be elected at initial recognition if doing so eliminates or significantly reduces an accounting mismatch. In addition, financial liabilities can be designated as at FVTPL if a group of financial instruments is managed on a fair value basis or if the designation is made in relation to embedded derivatives that would otherwise be bifurcated from the liability host. Changes in fair value attributable to changes in credit risk of the liability designated as at FVTPL are presented in OCI (and there is no reclassification to profit or loss).