

# TOPIC 11. Enterprise current assets and their financing

- 1.The contents, structure and classification of current assets.
- 2.The operational cycle, current assets management .
- 3.Evaluation of requirement for current assets.
- 4.Rationing of the enterprise current assets.  
Private cumulative standards.
- 5.Sources of the current assets formation.
- 6.Indicators of the current assets efficiency use.



# Didactic purposes:

- *Definition of enterprise current assets.*
- *Current assets classification.*
- *Understanding of the enterprise operational cycle.*
- *Classification of the current assets formation sources.*
- *Comparison of financial and production cycles.*
- *Analysis and planning of optimum requirement for the current assets.*
- *Calculation and analysis of indicators of the efficient use of current assets.*
- **Keywords:** *current assets, raw materials, materials, finished goods, operational cycle, financial cycle, norms of the current assets, transport stock, insurance stock, account payable, factor of current assets conversion cycle, factor of loading.*



# 1. Contents, structure and classification of the current assets.

- The current assets (CA) are the assets of the enterprise which are entirely consumed in single process of production, change their natural form, completely transfer their cost on the cost of finished goods.
- Their cost is compensated after each production cycle.
- The current assets are important for the enterprise, first of all, from a position of providing regularity and efficiency of their current activity.



# Positive features of the current assets:

- High degree of structural transformation - easy transformation from one form into another,
- High liquidity - the most part of the current assets can be quickly transformed into money,
- Easy management - turnover and sale within a short period of time.



# Negative features of the current assets:

- The part of the current assets being in a monetary form and in the form of receivables, is a subject to loss of real cost within time.
- Temporary free current assets do not generate profit, except short-term investments (we almost do not have it).



# Classification of the current assets:

- 1. *According to the character of the financial sources forming the current assets:*
- *Gross current assets - all their volume.*
- **GCA = inventory + receivables + cash + short-term investments**
- *Own current assets - that part which is created at the expense of own capital.*

**Own current assets = current assets - short-term liabilities**



## 2. *According to types:*

- Stocks of raw materials, materials, semi-finished products.
- Stocks of finished goods.
- Receivables.
- Monetary assets and short-term investments.
- Other short-term assets (expenses of future periods).



### *3. According to participation in operational process:*

- • Production Revolving Funds (current assets of production stocks and current assets in production).
- • Work-in-progress.
- • Semi-finished products of own production.
- • Expenses of future periods.
- • Working capital funds (ready made and in-process production; shipped but not yet paid production; money in cash desk; money on the way).



## 2.The operational cycle, current assets management .

- The operational cycle is time of a complete turnover of all sum of the current assets in the course of which there is a change of their separate types.

### **Movement of the current assets in the course of an operational cycle:**

- . Supply.
- . Production.
- . Shipment
- . Collection - receivables is covered by money.



- The most important characteristic of an operational cycle is its duration, including the period of time from the moment of the expenditure money for material stocks and to receiving of money from debtors.
- Duration of an operational cycle is determined by the following formula:  
  
 **$OS = M (\text{period of turnover CT}) + MS + FG + R (CP)$**
- . OS - operating cycle (days),
- . M - money,
- . MS - material stocks,
- . FG - finished goods,
- . R - receivables,
- . PT - **period of turnover**
- . CP - collection period.



In the current assets management, within an operational cycle, there are 2 components:

- 1. The production cycle of the enterprise - characterises the period of time of complete turnover of the material assets used for service of production process, from the raw materials arrival and till finished goods shipping.
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$$\mathbf{PC = WP (CT) + MS (CT) + FG (CT)}$$

- PC- production cycle (days),
- . MS - material stocks,
- . FG - finished goods,
- . WP - work-in-progress,
- . CT - cycle time.



- 2. The financial cycle is the period of complete turnover of the money invested in the current assets, from repayment of account payable for received stock and finishing with receivables for delivered finished goods.
- **FC = PC + R + AP (CT)**
- FC - financial cycle (days),
- . PC - production cycle,
- . R- receivables,
- . AP- accounts payable,
- . ON - cycle time.
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# 3. Evaluation of requirement for current assets.

- It is important for the enterprise to evaluate correctly the optimum value of current assets will allow to get profit with the minimum expenses.
- Otherwise there will be **an understating or overestimate of current assets size** that is negative for the enterprise, because:
  - 1) Understating of size of the current assets involves an unstable financial condition, interruptions in production and, as a result, decrease in production volume.
  - 2) Overestimate of the size of the current assets leads to freezing of means in the form of raw materials and the materials, finished goods etc. (it is quite expensive to the enterprise since costs of storage are high).



## For planning optimum current assets requirement it is possible to use 3 methods:

- The analytical method - it based on the definition of the needs in current assets in the amount of their average actual balances with the increase in production volume.
- 2. The coefficient method- stocks and expenses are subdivided on depending and not depending on change of volume of production. (Dependent) the need for the current assets is determined by variable expenses proceeding from their size in basic year and growth rates of production forthcoming year. On constant expenses the requirement is planned at average level the actual remains for a row of years.
- 3. The method of the direct account - provides reasonable calculation for each element of the current assets, that is rationing of the current assets enclosed in material stocks, a work in progress and finished goods.





**In general, the content of current assets planning can be represented as follows:**

- Development of standards for individual stock the most important types of goods and materials.
- Defining the norm in terms of money for each element of current assets and the total needs of the enterprise in the current assets.



# 4. Rationing of the enterprise current assets.

- During the formation of current assets developed norms and standards.
- The norms of current assets - a relative value corresponding to the minimum amount of economically viable reserves.
- The rate is set, as a rule, in these days, is calculated for each element of current assets and characterizes the value of a stock of goods and materials for a certain period of time required to ensure the continuity of the production process.



## For example, the norm of a stock in days by types of raw materials and materials includes:

- • *The transport stock* is time of finding of a material in a way.
- • *The preparatory stock* is the time necessary for acceptance, unloading and sorting of raw materials and materials.
- • *A technological stock* - when the material which is received from the supplier is impossible, at once to put in production: the sediment, the drying, any laboratory experiments is necessary.
- • *The current stock* is time of finding of the goods in a warehouse; provides everyday production by raw materials and a material.
- • *An insurance, guarantee stock* - at the large enterprises, reserves.



The general norm of the current assets on separate types of raw materials is defined:

$$GN = TS + PS + TehnS + CS + GS$$

- To define the standard of the current assets for raw materials and materials, it is necessary to increase the general norm in days by an one-day expense of materials.
- $S_{ca} = G_{nd} * E_{1d}$
- In the course of rationing of the current assets private and cumulative standards are defined.



# 5. Sources of the current assets formation.


- 1. *Own and attracted funds.*
- 2. *Equated to own means* (the minimum passing debt on social insurance and a salary, the minimum debt on reserves on a covering of the forthcoming expenses and payments, debt to the budget and off-budget funds, means in the form of an advance payment for production).
- 3. *Debt funds* (credits).
- 4. *Accounts payable.*




## There are 3 basic approaches to formation of the current assets:

- Conservative - provides not only full satisfaction of the current requirement for the current assets providing a normal course of operating activities, but also creation of high reserves on a case of unforeseen difficulties in providing with raw materials and goods.
- Such approach minimises operational risk, but negatively affects for the current assets efficiency use.



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- The moderate approach - is directed on complete ensuring the current requirements with all types of the current assets, on creation of normal insurance reserves on a case of the most typical failures in a course of operating activities.
  - At such approach the average ratio between risk and level of efficiency of use of the current assets is provided.



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- The aggressive approach - consists in minimisation of all forms of insurance reserves in the absence of failures in a course of operating activities.
  - Such approach provides the highest level of efficiency of use of the current assets, however any failures [*feilores*] lead to essential financial losses because of decrease in volume of production and production realisation.



## 6. Indicators of the current assets efficiency use.

- Current assets of the enterprise continuously make a circuit, moving from one stage to another. The rate of turnover in separate stages called their turnover.
- The faster turnaround means pass these stages, the more products the company can produce with the same amount.
- Turnover of current assets can be calculated according to the plan and actual.



The most important indicator of the current assets efficiency use is the rate of turnover, which is characterized by the following factors:

- 1. Turnover Ratio:
  - $R_t = \text{sales income} / \text{current assets}$
- 2. Duration of one turnover in days:
  - $D_d = D (\text{number of days in the period } 365) / R_t$
- It shows the number of days during which the current assets are all the stages of the circuit.



- 3. The load factor of current assets:
- $F1 = \text{current assets} / \text{sales income}$
- It characterizes the current assets attributable to one leu sales.
- As a result of the turnover is calculated the amount of savings and the release of funds or the amount of overspending (freezing) of funds.
- For this deviation turnover in days must be multiplied by the actual sale of a day.
- $E = (Dd_1 - Dd_0) * \text{sales income}_1 / D (360/365)$



- Calculate the indicators of the current assets efficiency use and the effect of savings or overspending of funds used to current assets financing :

Indicators	2014	2015
Sales income	102920	121856
Current assets	41200	32500