ТЕЗИ ДОПОВІДЕЙ
НА ПЛЕНАРНОМУ ЗАСІДАННІ

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FROM GROSS WORKING CAPITAL TO NET WORKING CAPITAL: SUGGESTION OF AN APPROPRIATE MODEL

During the 20th century the English language has established itself as the world's business language, hence, is the architect of accounting terms. Unfortunately, the English terminology used in financial statements also has shortcomings. There is a multitude of names, expressions and definitions, a myriad of financial terms and relationships which often are explained differently in various (text)books, papers and articles. There are several terms used as synonyms by many authors while others make a distinction between them. We know the meaning of the words used separately, but, used collectively, they can be mystifying.

In the paper the relationships between the different explanations of *working capital* are thoroughly analyzed.

American professors Welsch and Short state: «Working capital involves an arithmetical difference — total current assets minus total current liabilities. Thus, working capital is an abstraction because it does not represent a single asset, or group of similar assets, rather it includes total current assets and an offset — total current liabilities. It cannot be counted, handled, or used to settle receivables and payables. Because of its abstract nature, working capital often is not fully understood by statement users.» The author of this paper took the risk of being heretic and tried to determine the correct relationships between the terms *net assets*, *capital*, *net current assets*, *working capital*, *gross working capital*, *net working capital* and eliminate the anarchy in the usage of these terms. To build up a correct system of terms and give them proper substance, the conventional balance sheet format and well-known relationships between different parts of

balance sheet have been used. In the process of determining the correct relationships between the examined terms, semantical and logical connections have been followed. It means that the general (semantical, logical) rule — look for all kinds of capital on the liabilities and owners' equity side and all kinds of assets on the assets side of balance sheet — has been consistently followed.

Few analytical terms are more widely used and, at the same time, less understood than the term 'capital'. An analysis of accounting and finance literature shows that there is no standard definition of 'capital'. In the balance sheet *capital* should be shown under liabilities and owners' equity (or, to be more exact, capital as a noun could be used to describe items and/or parts of the liabilities and owners' equity side of the balance sheet). To take this into consideration *gross working capital* should be defined as **total claims** against *gross working assets* or (*gross*) *current assets*. It should be noted that **mathematically** the amount of *gross working capital* is equal to (*gross*) *current assets*, but these terms should not be considered synonyms because *gross working capital* and *gross current assets* are located on different sides of the balance sheet.

Let's reconsider the term *net assets*. It is impossible to separate or calculate the amount of *net assets* directly. For that reason, an indirect way to derive net assets from *owners' equity* should be used. It is necessary to express that **mathematically** the amount of *net assets* is equal to the *owners' equity* but that they are not identical (and, consequently, the terms *net assets* and *owners' equity* are not synonyms) because one of them is located on the left-hand (assets) side and the other on the right-hand (equities or capital) side of the balance sheet. *Net assets* should be defined as the amount of assets acquired through investments made by the owners. *Owners' equity* expresses the owners' claim (legal right) to a portion of business's assets, called ***net assets***.

Before defining *net working capital* it is useful to focus on one of the oldest principles in finance — the **matching principle**, which can be stated as follows: finance short-term needs with short-term sources, and finance long-term needs with long-term sources. The idea expressed in this principle is to «match» the maturity of the source of funds with the length of time the funds are needed. To follow this principle it is useful to exchange the places of long-term liabilities and owners' equity on the right side of the balance sheet. It makes it feasible to emphasize the substance of terms used to mark distinguished parts of the balance sheet. After that *net working capital* could be defined as the owners' claim to current assets and *net current*

assets as the amount of current assets acquired through investments made by the owners. This standpoint is supported by well-known professors Horngren and Harrison, who state: «Recall that capital or owners' equity is total assets minus total liabilities. Working capital is like a 'current' version of total capital.»

It should be noted that **mathematically** the amount of *net working capital* is equal to *net current assets*, but these terms should not be considered synonyms because *net working capital* and *net current assets* are located on different sides of the balance sheet. Analogically, *net working capital* and *net current assets* should not be considered synonymous. Unfortunately, it is not possible to derive *net working capital* **directly** from the right-hand side of the balance sheet. This is due to the fact that calculations are made **indirectly**:

Net working capital = Current assets – Current liabilities

Net current assets = Current assets – Current liabilities

As we can see the same formula is used for calculating net working capital as well as net current assets. So**, mathematically**, the amount of *net working capital* is equal to *net current assets*, but logically they cannot be synonymous for the simple reason that capital and assets are located on different sides of the balance sheet.

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THE NEW IFRS FRAMEWORK: PURPOSE AND DEVELOPMENT

The *Conceptual Framework* establishes the concepts that underlie financial reporting. It is a coherent system of concepts that flow from an objective. The idea of *Conceptual Framework* comes from the USA. The *Conceptual Framework* represents an attempt by the *FASB* to develop concepts useful in guiding the board in establishing standards and in providing a frame of reference for resolving accounting issues. This was the first time in history to develop such *Conceptual Framework* purpose of which was to be basis for future development of accounting standards. If the *FASB*'s framework was developed during 22 years (from 1978 till 2000) and consisted of six different documents then the *IASC*'s *Framework* was developed in