M7A1: Reclassification and Ethics

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**Effect of Reclassifying Long Term Assets as Short Term and Status of the Financial Position**

Current ratio measures the organizations capability to be able to give back its short term liabilities, for example, short term debt and accounts payable. Furthermore, it is a representation of the current assets and current liabilities and their respective ratios. The larger the ratio means that the entity is more liquid and has the capacity of paying back short term liabilities it owes. However, if the ratio is lower, then it means there is a deficit in the level of liquidity of the company and a deficit is also present in the fixed assets that are backed by short term debt (Henry et al., 2015)..

All in all this ratio measures the connection of the current assets with the current liabilities. So any change in the composition of the current assets and the current liabilities will directly impact the value of the current ratio. This ratio, as mentioned above, is then the measurement of a company’s financial position (liquidity) which will be either strengthened or weakened depending on how the proportion of current assets and current liabilities is changed within a company. This is what is primarily happening in relation to Ross’s Lipstick Company, which has reclassified its long term investments to cash within one year.

So if Ross’s Lipstick Company goes forward and reclassifies long term investments into cash (short term asset), this will be impacting the balance in the cash account. This way the cash account balance will increase and will further increase the ratio or proportion of the current assets that Ross’s Lipstick Company has. As it is already known that the value for this ratio is found by dividing the current assets by the current liabilities. So with this reclassifying of long term investment into cash, the balance between the current assets and current liabilities will be shifted and the current assets will increase compared to current liabilities. In this case, the current ratio of Ross’s Lipstick Company will also increase. This entails that by reclassifying an investment of a long term nature into cash will make the current ratio higher than compared to its value originally.

The fact of the matter is that Ross’s Lipstick Company’s true financial health will not become stronger just by reclassifying some long term investments as a short term because the total balance of assets will still remain the same. But for the time being Ross’s Lipstick Company can show that it has a strong financial position at least on paper due to a higher current ratio compared to what it was before reclassifying.

**Management Behaving Ethically or Not**

In the case considering Ross’s action to reclassify a long term investment into cash could be considered as ethically wrong. This is due to the fact that it showed that Ross and his company's management misrepresented the facts in order to serve themselves and their shareholders. This means that the information provided in the financial statements was not either true or fair (Duska, et al, 2018). This makes the financial statements as misleading sources of information for the different stakeholders of the company including their investors and their shareholders. There is also the element of materiality being present in the financial statements of Ross’s Lipstick Company. This is because Ross and his company's management have shown a sense of biases and moved forward with manipulating financial statements and the information provided in them to make their company look more desirable. This also shows that the company's senior management cannot be trusted to look after the affairs of the company as they are involved in activities that that revolve around covering up their efficiencies. Rather than improving their performance and use effective management techniques, they are relying on unethical behavior to mold financial ratios into their own favor. All of this is done to save face from their shareholders (Gong, 2017).

References

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