CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter concludes the research findings with respect to the extent of voluntary cash flow disclosures and the method of presenting operating cash flows. It also discusses the implication of the study and recommendations for future research.

5.2 Summary and Conclusions

This study is divided into two sections. The first being to investigate empirically the direct versus the indirect method of presenting operating cash flows. The second part of the study was to examine the relationship between the extent of voluntary cash flow disclosure and firm specific characteristics namely firm size, listing status, type of audit firm, leverage, assets-in-place, ownership diffusion, NACRA and industry. A total of 257 annual financial statements with year-end 2000 were extracted from the top 250 market ranking companies and the remaining randomly selected, form the sample for this study.

5.2.1 Descriptive Analysis

MASB 5 encourages enterprises to report cash flows from operating activities using direct method. This is because the direct method is more consistent with the objective of a statement of cash flows — to provide information about cash receipts and cash payments — than the indirect method which does not report operating cash receipts and payments. Form the frequency analysis, it may be noted that, despite the encouragement to use the direct method, the indirect method is overwhelmingly the popular method. Findings from the study showed, 85% of the companies use the indirect method, while only 15% of the companies use the direct method. Possible reasons quoted from prior research includes that the direct method would impose excessive implementation costs and that the indirect method provides more meaningful information (e.g. Krishnan and Largay, 2000). Even though there has been an improvement in firms using direct method to present operating cash flow, there is still a good 85% of companies not using the direct method. Because preparers of financial statement have the option to choose between direct and indirect method, makes the task more difficult of educating them to see the usefulness direct method cash flow information. A possible policy implication of this finding is that accounting bodies and regulators should mandate disclosure of direct method cash flow information in addition to the existing indirect reconciliation.

The results of univariate and multivariate tests are consistent. They suggest that firm size, listing, type of audit firm, NACRA and ownership diffusion, are statistically related to the extent of voluntary cash flow disclosure. Therefore, it would appear that voluntary disclosure helps to overcome agency costs as firms grow in size and employ a Big-5 audit firm.

Conversely, leverage, assets-in-place and industry are not statistically significant in either the univariate or multivariate analysis. This, suggest, that firms with high leverage are not inclined to disclose more information voluntarily to reduce information asymmetries. They have other means to disclose information voluntarily either in the form of compulsory disclosure of certain information at fixed interval to debt-holders as specified in the debt contracts or through the provision of debt covenants in the contract. Hence, voluntary reporting does not help the firms to reduce agency costs.

5.3 IMPLICATIONS

Part of the study results, suggest that there may exist a clear basis for mandating the direct format presentation of a cash flow statement. The direct method approach shows several advantages in presentation over the alternative that may be used. The other part of the study adds to the existing local accounting literature on cash flow disclosures. Although previous researches mainly overseas, have examined various aspects of cash flow statement, none however has examined the merits of additional disclosures on cash flow and relating it to firm specific characteristics. Further, these voluntary disclosures on cash flow statement are, encouraged to be disclosed, not only by MASB 5 but also by IAS 7 and FASB 95. This study also seems highly relevant in view of the of the fact that the Securities Commission (SC) has recently instructed listed companies to ensure their cash flow statements meet approved accounting standards (The Star Business, April 2001). It wants these statements to reflect the disclosure-based regulatory regime the SC is introducing, "where enhanced transparency, accountability and comparability of financial statement will be of paramount". The remainder was given following a review of financial statements of 100 companies for the financial years ended 1998 and 1999 regarding cash flow and found several common reporting deficiencies. These concerned, among others, adjustment of non-cash transactions; disclosure of accounting policy used for determining cash and cash equivalent components; and presenting of investing and financing activities. The SC has advised the public listed companies to take necessary corrective measures.

Thus the present study, which examines the extent of voluntary disclosure on cash flows and the alternative methods of presenting operating cash flow based on annual reports of firms with year-end 2000, will provide useful feedback to the accounting standard setters and regulators.

Based on the study, it was noted that firm size is the most significant variable that explains the extent of voluntary cash flow disclosure. It implies that larger firms have the financial resources to make greater disclosure in their annual reports. This is likely to be the result of a combination of factors, two of them being that it is relatively cheaper for them to collect and disseminate information, and that they are more in the public eye and need to keep the confidence of regulatory bodies. A possible implication to the policymakers is that they may have to consider the information needs of users of smaller firms' annual report. However, in doing so, the policymakers should take into consideration the cost and the potential benefits associated with increased disclosure by smaller companies.

5.4 Recommendations for Future Research

Although the present study provides useful insights into cash flow disclosure practices as mentioned in the preceding section, several aspects merit further investigation.

The study does have certain limitations. First, a self-selection bias may exist. The sample was not selected randomly from a larger population of annual reports. Rather, the top 250 market ranking companies' financial statements were used. This bias reduces comparability of the observed results to other smaller companies. Efforts must be extended to include more companies in the study in order to arrive at more concrete finding.

Second, part of the study focused primarily on cash flow from operations thus ignoring other potentially important cash flow variables and components of various cash flows.

Third, the present study only examines the extent of voluntary disclosure using cross-sectional data for a single year – 2000. Future research could test the robustness of the present study findings by extending empirical analysis over a longer period of time.

Future research can also extend the findings of the present study by exploring if users other than banks and investment analyst, actually look at the additional cash flow information if it is provided.

Finally, the most obvious opportunities in research relate to addressing these limitations. A fruitful avenue for future research is to investigate the information content of cash flow information contained in the statement of cash flows. Using cash flow from operations reported in the statement of cash flows avoids the problems associated with using proxies. Research could also investigate the predictive ability of reported and computed values of cash flow from operations. Examining the relationships between the components of operating cash flow would highlight the causes of the variability in operating cash flow. This can lead to identifying companies that are reducing inventory and receivables and increasing accounts payables to manipulate cash flow from operations.

Future research could also be in investigating the relationships between investing, financing and operating cash flows. This would indicate the major source of cash for a company. If a company, is, on the verge of bankruptcy for financial reasons, then one would expect to observe declining operating cash flows and increasing cash inflows from financing and investing. Probing which components of financing and investing cash flow is providing cash would reveal information not discernible from the income statement and the balance sheet.

5.5 Conclusion

The current study extends the previous research of Ng (1996) who examined the alternative treatments of direct and indirect methods of presenting operating cash flows, interest and dividend received and paid, and taxation paid. The research undertaken here adopts a different approach in that it that it re-examines the alternative treatments of direct and indirect methods of presenting operating cash flows and whether economic incentives exist to motivate the use of direct method and disclosing voluntarily other cash flow information. The firm specific characteristics used in the study to test the influence on the extent of voluntary disclosure on cash flow includes firm size, listing status, leverage, proportion of assets-in-place, type of audit firm, ownership diffusion, NACRA and industry. The results of the study suggest positive association between extent of disclosure and firm size, listing, type of audit firm, NACRA and ownership diffusion. Conversely, leverage, proportion of assets-in-place and industry do not have a significant association with the extent of voluntary cash flow disclosure.

Finally, the present study can be taken to be in line with the NACRA objective emphasizing on voluntary disclosure over and above compliance with mandatory disclosure requirements.

It is also expected that the benefits from voluntary corporate information over and above the legal disclosure requirements far outweigh any disadvantages companies may suffer. Ultimately this will lead to a publication of timely, informative, factual and reader-friendly annual report.