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Cash Flow Reporting Practices in Bangladesh: A Study on Textile and Clothing Companies

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Abstract—*Cash flow statement is an integral part of the financial statements. Although preparation of cash flow statement is not mandatory as per Companies Act 1994, public limited companies enlisted with stock exchange are to prepare this statement as per other statutory laws and regulations. Since cash flow statement endows with information on the cash flows from a company's operating, investing and financing activities to enable users of its financial statements to appraise the ability of the company to generate cash and to predict cash flows, companies are now preparing this statement as an fundamental part of their financial statement. This paper examines empirically the current practices followed by sample companies in preparation of cash flow statement and concludes that sample companies are in line (with a few exceptions) with the requirements of International Accounting Standard–7 (IAS-7) and Bangladesh Accounting Standard- 6 (BAS-6) and suggests to overcome these exceptions by following BAS-6.*

Keywords and Phrases: Cash flow statements, IAS, listed company.

JEL Classification: M41.

1. INTRODUCTION

The purpose of a cash flow statement is to provide information on the cash flow from a company's operating, investing and financing activities to enable the users of its financial statements to evaluate the ability of the company to generate cash and to use the historic cash flows to predict future cash flows. Cash flow information enhances the comparability of the reporting of operating performance by various companies, because it eliminates the effects that arise from the use of different accounting treatments for the same transactions and events.

2. LITERATURE REVIEW

The use of cash flow information is gaining in importance in the analysis of financial statements (Epstein 1991; Yap 1997; Jones and Widjaja 1998; Previts and Bricker 1994). Cash flow information is considered less open to manipulation than information on earnings, because it is based on the actual receipt and payment of cash only and not on the accrual and other accounting principles. Rees (1995) adds that the cash flow statement can be more informative than the other statements. However, the literature on the cash flow statement indicates that there are grey areas in cash flow reporting that are open to various interpretations (Everingham and Watson 2002). The perceived simplicity of the cash flow statement may therefore create false confidence in the reliability of companies' cash flow reporting and the comparability of various companies' cash flow information. Cash Flow Statement has added a new dimension to the preparation and presentation of financial statements in Bangladesh.

3. OBJECTIVES OF THE STUDY

The objective of the study is to investigate and represents current practices of cash flow statement format, structure and reporting on the basis of information provided in the annual reports of selected Textiles & Clothing companies enlisted with the stock exchanges in Bangladesh. The focus is not on the quality of the reporting of the companies but rather on what the reporting levels are in general.

4. METHODOLOGY OF THE STUDY

A limited survey has been made covering a total of 19 Textiles and Clothing companies {Bangladesh Dyeing & Finishing Industries Ltd (2007), Apex Weaving & Finishing Mills Ltd. (2007), Sreepur Textile Mills Ltd. (2007), Dandy Dyeing Ltd. (2007), Square Textile Ltd. (2007), Mita Textile Ltd. (2007), CMC-Kamal Textile Mills Ltd. (2007), Mithun Knitting & Dyeing (2007), H.R Textile Mills (2007), SaihamTextile Mills Ltd. (2006), Delta Spinners Ltd. (2007), Eagle Star Textile Mills Ltd. (2007), Sajib Knitwear & Garments Ltd. (2007), Prime Textile Ltd. (2007), Safko Spinning Mills Ltd. (2007), Monno Fabrics Ltd. (2007), Bextex Ltd. (2007), Tamijuddin Textile Ltd. (2007), Sonargaon Textile Ltd. (2007} annual reports enlisted in Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). Those are selected on the basis of random sampling procedure. In order to make the study more revealing it also covered some research articles, textbooks, publications and web sites of various accounting bodies.

5. LIMITATIONS OF THE STUDY

This study consists only nineteen listed Textiles & Clothing companies due to resources constraints like scarcity of available and relevant data. Dealing with more companies would have been more representative. Another limitation of the study is that it does not cover all the disclosing issues related to cash flow statement rather focus is on some selected disclosure issues.

6. OVERVIEW OF THE CASH FLOW STATEMENT

The cash flow statement explains the changes that have occurred in the company's cash and cash equivalents during the year by classifying the cash flows in its operating, investing and financing activities. The statement must focuses on cash receipt and payments and must explain the change in cash plus cash equivalents. The classification is done in a way that is most appropriate to the company's business.

The following are the definitions of the components of the cash flow statement-

Cash: Cash on hand and demand deposits.

Cash equivalents: Short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Operating activities: The principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

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

Financing activities: Activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

6.1 Objectives and Scope of IAS- 7, Cash Flow Statements

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. The economic decision are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and timing and certainty of their generation. The objective of IAS-7 is to require the provision of information about the historical change in cash and cash equivalents of an enterprise by means of a cash flow statement that classifies cash flows during the period from operating, investing and financing activities. An enterprise should prepare a cash flow statement in accordance with the requirements of IAS-7 and should present it as an integral part of its financial statements for each period for which financial statements are prepared. Users of an enterprise's financial statements are interested in how the enterprise generate and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial institution. Enterprises need cash for the same reasons however their principal revenue- producing activities might be different. They need cash to conduct their operations, to pay their obligations, to provide return to the investors. Accordingly this standard requires all enterprise to present a cash flow [Para 1 and 3 of IAS-7].

6.2 Benefits of Cash Flow Information

The information in a cash flow statement helps investors, creditors, and other to assess the following aspects of the firm's financial position.

(a) Such statements serve as a mechanism for predicting the ability to generate future cash flows for the investors, creditors and others.

(b) This enables managers or management to plan, coordinate and control financial operation in an effective manner.
(c) It gives an indication of the relationship between profitability and cash generating ability thus of the quality of the profit earned.
(d) It furnishes information to the management regarding the entities ability to pay dividend and meet obligations.
(e) Analyst and other users of financial information often, formally or informally, develop models to assess and compare the present value of the future cash flow of entities. Historical cash flow statements could be useful to check the accuracy of past assessment (ACCA text book part 2. p.324).
(f) It is free from manipulation and is not affected by subjective judgments or by accounting policies.
(g) Such a statement dictates situations when a business has made huge profit but has run out money or it has sustained loss but has enough cash availability.
(h) The extent of cash generated from operational activity and external finance in order to meet capital, tax, and dividend requirements can be obtained from such statements (Lee.1972:27-36).
(i) It aids in the evaluation of risk, which includes both the expected variability of future return and probability of insolvency or bankruptcy (Hendrickson, Eldom.1982: 237).
(j) Such statements reveal the capability of an enterprise to pay its short obligation as and when due to the lenders.
(k) A cash flow statement in conjunction with a balance sheet provides information on liquidity, viability and adaptability. The balance sheet is often used to obtain information on liquidity, but the information is rather incomplete for this purpose as the balance sheet is prepared at a particular point in time.
(l) It may assists users of financial statements in making judgments on the amounts, timing and degree of certainty of future cash flows.
(m)This statement provides information that is useful in checking the accuracy of past assessment of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing price (Para 3 and 4 of IAS-7).
(n) Information on cash flows classified by three groups of activities (Operating, investing and financing) that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be to evaluate the relationship among those activities (Para 11 of IAS-7).
(o) This statement is of special importance in assessing future cash flows, quality of income operating capability, financial flexibly and liquidity, and information on financing and investing activities. Using cash flows from operating activities from the cash flow statements, different ratios such as liquidity ratios, solvency ratio, and profitability ratios can also be calculated to evaluate an enterprise liquidity, solvency, and profitability (Aziz uddin and Bala. 2001: p. 14).

6.3 Presentation of Cash Flow Statement under IAS-7

(A) Cash and cash equivalent:
The definition of cash and cash equivalent are central to the preparation and interpretation of cash flow statements. Cash consists of cash on hand and demand deposits, coins and notes of an organization. In our country deposits in postal accounts may be termed as cash (Cooper and Ijiri. 1984: 88; Ghosh. 2001). Cash equivalent are short-term, highly liquid investments that are readily convertible into known amount of and which are subject to an insignificant risk of change in value. According to the definitions of paragraph 6 of IAS-7, cash comprises cash on hand and demand deposits; usually 'cash on hand' includes currency, notes, and coin in the cash box of the enterprise. It also includes prize bond, negotiable money orders, postal orders, and undeposited checks, bank drafts or pay- order. Demand deposits refer to deposits in checking accounts in banks and other financial institution that may be withdrawn without notice usually subject to deduction of outstanding check. Thus cash equivalent –
(1) are short-term investments but the term 'short' not clearly specified, although a period of three month and less is suggested to take as short term period.
(2) are highly liquid investments. Here 'liquid' means having in a situation where cash equivalent are available in sufficient amount to meet obligation due for payments.
(3) are investments that are both: (a) readily convertible, to known amounts of cash and (b) subject to an insignificant risk of change in value. According to SFAC No. 95, the risk categorically refers to risk of change interest rate. The short-term investment is so near their maturity that they represent insignificant risk of changes in interest rate. Examples included treasury bills, commercial papers, and money market funds purchased with cash that is in excess of immediate needs.

However although by definition, *cash equivalents* refers to short term highly liquid investments, they are usually held for the purpose of meeting short term cash commitments rather than or other purpose. For an investment to qualify as a cash equivalent it must be ready convertible to a known amount of cash and be subject to insignificant risk of change in value. Therefore an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months and less from the date of acquisition. Equity investments are excluded from the cash equivalents unless they are in substance, cash equivalents, for examples in the case of preferred share acquired within a short period of their maturity and with a specified redemption date (Para 7 of IAS-7).

7. PREPARATION OF CASH FLOW STATEMENT

IAS-7 requires cash flows to be classified into operating, investing, and financing activities.

7.1 Cash Flows from Operating Activities

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

a) cash receipts from the sale of goods and the rendering of services;
b) cash receipts from royalties, fees, commissions and other revenue;
c) cash payments to suppliers for goods and services;
d) cash payments to and on behalf of employees;
e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;
f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
g) cash receipts and payments from contracts held for dealing or trading purposes [Para 14 of IAS-7].

IAS-7 permits a choice between two possible methods for reporting net cash flow from operating activities.

- The **direct method** whereby major sources of gross cash receipt and gross cash payments are shown.
- The **indirect method** starts with profit before tax and adjusts it for non-cash charges and credits to reconcile it to the net cash flow from operating activities.

7.2 Cash Flows from Investing Activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:
a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self constructed property, plant and equipment;
b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
c) cash payments to acquire equity or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
d) cash receipts from sales of equity or debt instruments of other enterprises and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities [Para 16 of IAS-7].

7.3 Cash Flow from Financing Activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by

providers of capital to the enterprise. Examples of cash flows arising from financing activities are:
a) cash proceeds from issuing shares or other equity instruments;
b) cash payments to owners to acquire or redeem the enterprise's shares;
c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
d) cash repayments of amounts borrowed; and
e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease [Para 17 of IAS-7].

7.4 Variations in Reporting Activities for Cash Flows

Reporting practices are varied from companies to companies in terms of operating, investing and financing activities.
(A) Operating or financing activities
Transactions with different categories included in cash flows are classified in a different manner. According to (Para 12 of IAS-7) "A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital the interest element may be classified as operating activities and the capital amount is classified as financing activities".
(B) Operating or investing and financing Activities
Some cash flows may be classified as arising any activities such as 'interest' 'dividend' 'income tax'. The detailed provisions of these types are as follows.
(1) Interest:

(a) For a financial institution, interest paid and interest received are usually classified as *operating* cash flows (Para 33 of IAS-7).

(b) For other enterprise, interest paid and interest received may be classified as *operating* cash flows because they enter into the determination of net profit or loss. Alternatively, interest paid may be classified as *financing* cash flows, because they are costs of obtaining financial resources. Interest received may be classified as *investing* cash flows, because they are returns on investments (Para 33 of IAS-7).

(2) Dividend:

(a) For a financial institution, dividends received are usually classified as *operating* cash flows (Para 33 of IAS-7).

(b) For other enterprise, dividends received may be classified as *operating* cash flows because they enter into the determination of net profit or loss. Alternatively dividend received may be classified as *investing* cash flows, because they are returns on investments (Para 33 of IAS-7).

(c) Dividend paid may be classified as *financing* cash flows, because they are costs of obtaining financial resources. Alternatively dividend paid may be classified as *component of* cash flows from *operating* activities in order to assist users to determine the ability of an enterprise to pay dividend out of operating cash flows (Para 34 of IAS-7).

(3) Income tax:

Taxes on income arise on a transaction that gives to the cash flows that are classified as operating, investing, and financing activities in cash flow statement. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transactions. Therefore taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow within individual transaction that gives rise to cash flows that are classified as investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed (Para 36 of IAS-7).

In the light of SFAS 95, "Transaction that enter into the determination of net income" are defined as operating activities and hence, interest received or paid, dividend received and taxes on income are rigidly treated to arise from operating activities. Dividend stakeholders are treated as cash outflows classified as financing activities (Keiso and Weygandt. 1998: 1275-76).

8. CASH FLOW STATEMENT PRACTICES IN BANGLADESH: REGULATORY FRAMEWORK

8.1 In the Eyes of the Companies Act 1994, (Act no. 18 of 1994)

According to the section no. 183 of the Companies' Act 1994 (which came into effect from January 01 1995), a company is required to present balance sheet, profit and loss account. (Income and expenditure account, in case of non-profit companies). Under section 185, the balance sheet and income statement have to be prepared according to the forms set out in Part –1 and Part –2 of Schedule XI respectively. Under which information on consecutive two years (concerned year and preceding year) are to be provided. However according to note (g) of the general instruction for preparation of balance sheet (given in part – 1 of schedule XI after the horizontal format of the balance sheet), "a statement of change in financial position shall be included as an integral part of the financial statements, and shall be presented for each period for which the profit and loss account is prepared". No *Cash Flow Statement* is being prescribed by the Companies Act 1994.

8.2 In the Light of the Security and Exchange Rule 1987 (S.R.O No. 237-l/87 dated on 28 September 1987)

Under the provision of rule 12 (1) of the Securities and Exchanges Rules (SER) 1987(amended by the section notification No. SEC/ Section 7/SER/03/132 dated 22 october1997 published in the official gazette on 29 December 1997), the annual report to be furnished by an issuer of listed security shall include "a balance sheet, profit and loss account, *cash flow statement* and notes to the accounts collectively hereinafter referred to as the financial statement'. In *the* part III of the Schedule of the SER 1987, issues relating to interest paid on short-term borrowing, interest and dividend received income taxes are clearly guide lined. For example, interest paid on short-term borrowing, shall be a cash outflow under *operating activities*; 'interest and dividend received' shall be a cash inflow under *investing activities* and 'interest paid on long term borrowing' and 'dividend paid' shall be a cash outflow under *financing activities.* Under paragraph 35-36, 'taxes on income' should be treated as operating cash outflow unless they can be identified in financing and investing activities.

9. FINDINGS OF THE STUDY

To know the extent of cash flows statements reporting practices by Textiles and Clothing companies, a survey has been conducted covering 19 annual reports. This study covered annual reports of 2007, (year 2006 in case of non-availability) of surveyed companies. The majors finding of the study are given below in terms of General, Variations in reporting and voluntary disclosure.

9.1 General Findings

It includes the current format and structure of cash flow statement and the extent of compliance of IAS-7, followed by sample Textiles and Clothing Companies in Bangladesh.

- All the sample companies prepare cash flow statement as required by International Accounting Standard-7 (BAS 6) adopted by the Institute of Chartered accountant of Bangladesh and present it as an integral part of the financial statements. Notes to cash flow statement have been presented as part of the financial statements in case of all the sample companies.
- The sample companies prepare Cash flow statement in vertical form and shows figure of cash flows of the current year and previous year.
- All the sample companies' cash flow statement contains a classification in operational, investing, and financing activities.
- The sample companies did not illustrate the policy adopted in determining the formulation of cash and cash equivalents although this is required by paragraph 36 of IAS-7.

9.2 Variations in Reporting

Another objective of the survey was to determine which alternatives, permitted by IAS-7, are used most in practice by Bangladeshi Textile and Clothing companies. It is found that there are not many differences between companies in their reporting of cash flow information. This is expected because the preparation of cash flow statement does not allow for many choices, differences of interpretation or different accounting treatments. The results are set out in table 1.

- Refer to 2 of table 1 and according to IAS-7 (table 2) and SEC Rule 1987 enterprises are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. All the sample companies followed the direct method in reporting operating cash flows. One company (Mithun knitting & Dyeing Ltd.) discloses cash flows from operating activities under indirect method in notes of financial statements as additional information.

Table 1: Variations in Reporting [Cash Flow Statement (CFS)]

Factors	Options	Number
1. Notes to CFS	Separately, following the CFS	0
	Part of the notes to the financial statements	19
	Incorporated in the CFS	0
	Total	19
2. Operating activities	Direct method	19
	Indirect method	0
	Total	19
3. Interest received and Interest paid	Operating activities or no interest	18
	Financing or Investing activities	1
	Total	19
4. Dividend received and Dividend paid	Financing activities or no dividends	18
	Operating activities	1
	Investing activities	0
	Total	19
5 Definition of cash and cash equivalents	Part of accounting policy note	12
	Nothing disclosed	7
	Total	19
6 Income tax	Operating activities or no tax	15
	Financing activities	4
	Investing activities	0
	Total	19

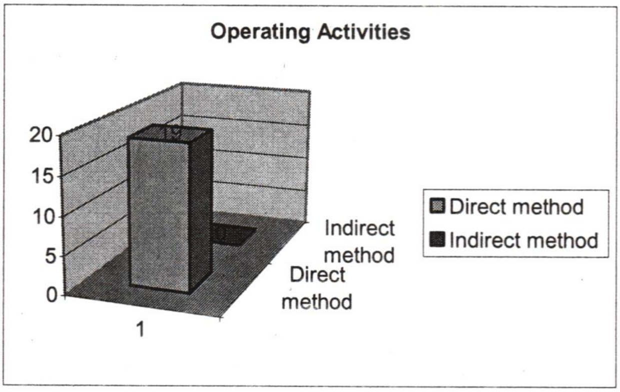

Figure 1. Operating activities

- Refer to the 3 & 4 of table 1 and according to IAS-7 (table 2), all the companies studied (except one) have shown 'interest received and paid' under operating activities and 'interest paid on long term borrowing' and 'dividend paid' under financing activities.

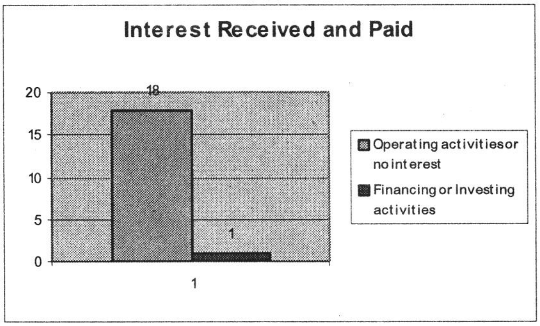

Figure 2. Interest received and paid

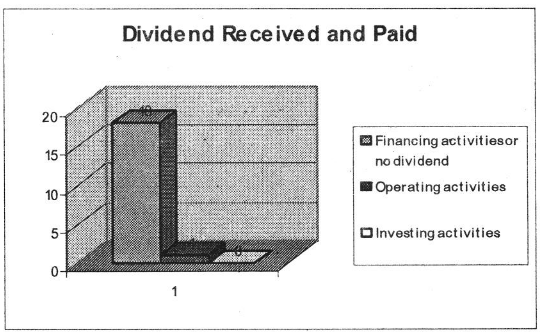

Figure 3. Dividend received and paid

9.3 Voluntary Disclosure

The survey also included an examination of any additional information that is disclosed regarding the company's cash flow which is not required by IAS-7, but which may be helpful to the user. For example, separate disclosure of cash flows that increase operating capacity and cash flows that maintain operating capacity, disclosure of segmental cash flows, cash flow per share etc. The survey found no company to disclose such additional voluntary information in its cash flow statement.

10. CONCLUSIONS AND RECOMENDATIONS

A materially misstated cash flow statement, whether it is in terms of incorrect classification in the categories or numerical accuracy, can be misleading to the user and can lead to wrong decisions taken by the usurers of statements. The survey has revealed that although sample companies prepare cash flow statement according to International Accounting Standard-7 and (BAS-6), there is also a degree of non-compliance. It is, however, found that there are not many differences between companies in their reporting of cash flow information. This is expected because the preparation of cash flow statement does not allow for many choices, differences of interpretation or different accounting treatments. To make cash flow statement more informative and useful for users the companies should disclose additional voluntary information such as cash flow per share in their cash flow statements and also items consisting of cash flows from operating, investing and financial activities should be clarified in the notes of the financial statements. Due to the limited scope of the present study, a large number of research issues have not been attempted but are identified in the course of the study. Disclosure practice of additional items other than operating, investing and financing activities, disclosure practice differences between listed and unlisted companies, disclosure practice differences between financial and other institutions are such potential issues for future research.

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