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# Statement of Cash Flows Disclosures: A Study on Listed Financial Institutions in Bangladesh

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*The aim of this study is to know whether the listed financial institutions of Bangladesh follow the required accounting standard and related statutory laws in preparing the cash flow statements. To fulfill the objective of the study, Cash Flow Statements (year 2010 to 2014) of all the listed financial institutions (twenty three companies) were analyzed. This study shows that the current practices of the preparation of cash flow statements of all the listed financial companies are almost similar and follow the requirements of International Accounting Standard 7 (Bangladesh Accounting Standard 7) and other statutory laws.*

**Key words:** Statement of Cash Flows, IAS/BAS 7, Financial Institutions, Disclosures.

**Field of Research:** Accounting and Finance

## 1. Introduction

The separation of management from ownership in modern business calls for the use of some form of connection between the managers and the owners and other interested parties. Financial reporting is the most efficient and extensively used medium of communicating the operating results as well as the latest financial position of a concern.

A cash flow statement is a financial report that describes the sources of a company's cash and how that cash was spent over a specified time period. It does not include non-cash items. The cash flow statement is a cash basis report on three types of financial activities: operating activities, investing activities, and financing activities. Non-cash activities are usually reported in footnotes. Statement of cash flows provides the answer to the following simple but important questions about an enterprise (Keiso & Weygand 1998)

i. Where did the cash come from during the period?
ii. What was the cash used for during the period?
iii. What was the change in the cash balance during the period?

The acceptance of IAS-7 (Statement of Cash Flows) has added a new dimension to the preparation and presentation of financial statements in Bangladesh.

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There are 22 categories of industries listed in the Dhaka Stock Exchange (DSE). Financial institutions are one of the listed industries in DSE and this industry consists of 23 listed companies. Each and every listed financial institution is analyzed to fulfill the research objective.

According to Financial Institutions Act, 1993, financial institution means such non-banking financial institutions, which- i) make loans and advances for industries, commerce, agriculture or building construction; or ii) carry out the business of underwriting, receiving, investing and reinvesting shares, stocks, bonds, debentures issued by the Government or any statutory organization or stocks or securities or other marketable securities; or iii) carry out installment transactions including the lease of machinery and equipments; or iv) finance venture capital; and shall include merchant banks, investment companies, mutual associations, mutual companies, leasing companies or building societies.

The objective of the study is to know whether the listed financial institutions of Bangladesh follow the required accounting standard and related statutory laws in preparing the cash flow statements.

In Bangladesh, a few works have been done regarding disclosure practices on cash flow statements. Listed banks and pharmaceutical companies of Bangladesh have already been studied. But no research was found on the cash flows disclosure practices of listed financial institutions in Bangladesh. Existing and potential capital market investors have good interests in the financial statements of listed financial institutions of Bangladesh. A large number of investors invest their fund in this industry. From this study, accounting information users of these companies would gain confidence on the cash flow statements prepared by these companies.

The remainder of the paper is organized as follows: Section 2 presents the previous studies on cash flow statements. Section 3 explains the methodology of this study. Discussion and results of the research are presented in Section 4 whereas the conclusions appear in the last section.

## 2. Literature Review

Numerous studies were performed on cash flow statements throughout the world. But few researches were found on cash flow statement disclosure practices.

Some researchers studied on the superiority of direct and indirect method of presenting cash flows from operating activities. Krishnan & Largay (2000) investigated a sample of US firms that provided direct method cash flows from 1988 to 1993 to know whether the direct method is empirically superior to the indirect method in predicting future cash flows. Their findings suggest that past cash flow data are more useful than past earnings and other accrual data in forecasting future cash flows and the accuracy of cash flow prediction is enhanced when both direct method cash flow data and earnings and other accrual data are used. Clinch et al. (2000) found evidence that direct method cash flow components have significant explanatory power beyond indirect method cash flow components. Orpurt & Zang (2009) provided that direct method cash flow disclosure is incrementally informative compared to indirect method disclosures when predicting future cash flows from operations and earnings. Ali Mohobbot et al. (2008) also studied the popularity of cash flow reporting method in Bangladesh. They surveyed different user groups such as managers, shareholders, employees, suppliers and customers. Their results demonstrated that overall the direct method of reporting cash flows considered superior to the indirect method by these user groups.

Level of voluntary disclosures of cash flow information was the concentration of a group of researchers. Berglof and Pajuste (2005) examined the level of disclosures in 10 Central and Eastern European countries and found high discrepancies in the level of disclosure among firms, and especially among countries. Barac Z A (2012) focuses on the voluntary disclosure of cash flow information of Croatian listed large companies to identify characteristics of companies that provide extensive disclosures. This study indicated that despite the desire of the regulatory authorities that capital-market investors receive all relevant information, companies voluntarily disclose information about cash flows very rarely.

Christian Leuz (2000) studied the determinants of voluntary and international cash flow statements for a sample of 103 large German firms at three different points in time. Researcher found major changes in the disclosure of cash flow statements by German firms: In 1992, the majority of sample firms did not provide cash flow (or even simple fund flow) statements. Only four years later, this situation had completely changed. In 1996, most sample firms disclosed cash flow statements in line with international reporting practice. This strong trend towards international cash flow statements seems to have been influenced by the international standards for cash flow statements as well as the German professional recommendation HFA 1995. This paper analyzed the cross-sectional determinants of voluntary (international) cash flow statements using regressions and factor analysis. The results supported the idea that capital-market forces drive the disclosure of cash flow statements that conform to international reporting practice.

Other studies on cash flow statements are also significant. Wasley and Wu (2006) found that management presents cash flow forecasts to signal good news in cash flow, to meet investor demand for cash flow information and to reduce the degree of freedom in earnings management. Bahnson et al. (1996) showed that figure from the balance sheet and income statement often do not articulate with the appropriate figures for operating cash flows.

To identify the current practices of preparing and presenting the cash flow statement of listed pharmaceutical companies in Bangladesh, Siddiqua and Hossan (2012) studied 12 listed pharmaceutical companies of Bangladesh. They concluded that almost all the sample companies follow the applicable accounting standard in preparing and presenting the cash flow statements. With the same objective Khan, M.H. et al. (2005) also studied 20 listed banks in Bangladesh and found almost similar results.

## 3. Methodology

556 companies are listed in the Dhaka Stock Exchange. DSE classified these companies into 22 industry categories. One industry, namely financial institution was selected for this study,

which includes 23 companies and all the company's cash flow statements were analyzed to meet the study objective.

The study is conducted for a period of recent five financial years, from 2010 to 2014. This is a descriptive research and no statistical techniques were applied. In this study, mainly secondary data were used. Annual reports of all the selected companies (year 2010 to 2014) have been studied to fulfill the major objective of this study. In order to make the study more revealing it also covers some research articles, textbooks, and publications.

## 4. Discussion and Findings

### 4.1 International Accounting Standard-7 and Regulatory Framework Regarding the Preparation of Financial Statements

The purpose of the International Accounting Standard 7 is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.

Cash flows are inflows and outflows of cash and cash equivalents. Cash comprises cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities. Summary of IAS 7 is presented in the following table:

**Table 1: summary of IAS 7**

| IAS 7/ BAS 7 | Explanation |
|---|---|
| Objective of the standard | To require the provision of information about the historical changes 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. |
| Scope of the standard | 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 (IAS 7.1). |
| Classification of cash flows | IAS 7.10 requires an entity to analyze its cash inflows and outflows into three categories: operating, investing and financing activities |
| Presentation of operating cash flows using the direct or indirect method | IAS 7.18 requires an entity to present its cash flows from operating activities using either the direct or the indirect method. Although IAS 7.19 encourages the preparation of a cash flow statement using the direct method. |
| Reporting cash flows from investing and financing activities | An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22and 24 are reported on a net basis. |
| Accounting guideline for interest paid and received | For a financial institution, interest paid and interest received are usually classified as operating cash flows (IAS 7.33). |
| Accounting guideline for dividend paid and received | For a financial institution, dividends received are usually classified as operating cash flow (IAS 7.33). Dividend paid may be classified as financing cash flows, because they are costs of obtaining financial resources. |
| Accounting guideline for income tax | IAS 7.35 requires cash flows arising from income taxes to be disclosed separately, and classified within operating activities unless they can be specifically associated with financing or investing activities. |
| Further disclosure regarding tax purposes | When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed (IAS 7.36). |
| Non-cash transactions | Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flow. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities (IAS 7.43). |

**In accordance with the Companies Act 1994 (Act no. 18 of 1994):** According to Section 183 of the Companies' Act 1994 (which came into effect from January 1, 1995), a company is required to present a balance sheet, profit and loss account (income and expenditure account, in case of nonprofit companies). Under section 185, the balance sheet and the 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". However, no specific format of the cash flow statement has been prescribed in the Companies Act 1994.

**In the light of the Security and Exchange Rules 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 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 depicted. 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.

**In accordance with the Financial Institutions Act 1993 (chapter vii: submission of accounts and audit of accounts):** According to Section 23 of Financial Institutions Act 1993 (Published in Bangladesh Gazette Extraordinary Dated 30th September, 1993), the directors of every financial institution shall submit to the Bangladesh Bank a copy of the profit and loss account and balance sheet prepared in accordance with the Companies Act.

## 4.2 Findings of the Study

IAS-7 requires maintaining the provision of information about the historical changes in cash and cash equivalents of an enterprise and we found all the listed financial institutions follow this guideline. IAS-7 also provides guidelines regarding interest paid and received, dividend paid and received, tax payment, disclosure of further tax, classification of business activities into operating, investing and financing, etc. From this study it is found that each and every listed financial institution maintains the related guidelines very effectively and efficiently. All the financial institutions prepare a cash flow statement using the direct method which is encouraged by IAS-7.

Security and Exchange Rule 1987 required to maintain a cash flow statement and required to illustrate interest paid on short-term borrowing, interest and dividend received as well as income taxes. This study reveals that all the listed financial institutions follow the Security and Exchange Rule 1987 regarding the preparation of cash flow statement.

According to the Companies Act 1994 and the Financial Institutions Act 1993, preparation of the statement of cash flows is not mandatory. But all the listed financial institutions are preparing cash flow statement to comply with the requirements of International Accounting Standard 7, Security and Exchange Rule 1987 and other related regulatory bodies.
Findings' of this study are summarized in the following table:

**Table 2: Summary of the findings**

| Basis of Findings | Particulars | Compliance | Non compliance |
|---|---|---|---|
| International Accounting Standard7/ Bangladesh Accounting Standard 7 | Maintaining the provision of information about the historical changes in cash and cash equivalents of an enterprise. | √ | |
| | Preparing a cash flow statement in accordance with the requirements of IAS 7. | √ | |
| | Presenting it as an integral part of its financial statements for each period for which financial statements are prepared. | √ | |
| | Classified as operating, investing and financing activities. | √ | |
| | Following the Accounting guideline for interest paid and received. | √ | |
| | Following the Accounting guideline for dividend paid and received. | √ | |
| | Following the Accounting guideline for tax payment. | √ | |
| | Maintaining Para 36 of IAS-7 regarding further disclosure of tax. | √ | |
| | Definition of cash and cash equivalents should disclose in the notes to the financial statements part. | √ | |
| | IAS 7.19 encourages the preparation of a cash flow statement using the direct method. | √ | |
| | An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraph 22 and 24 are reported on a net basis. ( IAS 7.21) | √ | |
| Companies Act 1994 (Act no. 18 of 1994) | Not mandatory to prepare the statement of cash flows. | | |
| Security and Exchange Rule 1987 | Required to maintain a balance sheet, profit and loss account, cash flow statement and notes to the accounts collectively referred to as the financial statement | √ | |
| | Required to depict interest paid on short-term borrowing, interest and dividend received as well as income taxes. | √ | |
| Financial Institutions Act 1993 (chapter vii: submission of accounts and audit of accounts) | Not mandatory to prepare the statement of cash flows. | | |
| General Findings | ▪ The management of the samples companies authenticated the cash flow statements.<br>▪ Statement of cash flows of all the studied companies have been audited by the independent auditor and it is clearly mentioned in the auditors' reports.<br>▪ Cash flows statements of the studied companies show figure of cash flows from operating, financing and investing activities of the current year and previous year. | | |

## 5. Conclusion

The results of this study support the previous study results of Siddiqua and Hossan (2012) and M.H. et al. (2005) though they studied different industry. The significance of this study is that the stakeholders of these companies can know whether these companies prepare their cash flow statements in accordance with the related accounting standard and other regulatory laws. Cash flows statement is significant to management for proper cash planning and maintaining a proper match between cash inflows and outflows. Investors, creditors and other stakeholders' crucial area of concern are the liquidity and solvency of an enterprise that in turn is dependent on the smooth flows of cash within an enterprise. That's why this financial statement is of considerable importance, which helps in assessing the operating capability, income quality, strong financial flexibility, or at least allows creditors for being "tension free" for recovering their money. Limitations of this study include: this paper covered only the listed financial institutions but did not consider other listed and unlisted companies; due to time constrain the study period was only five years and no statistical techniques were used because of its descriptive nature.

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## Appendix

**List of the studied 23 listed Financial Institutions:**

- LankaBangla Finance Ltd.
- Investment Corporation of Bangladesh.
- First Lease Finance and Investment Ltd.
- Bangladesh Industrial Finance Company Ltd.
- Industrial Promotion & Development Corporation of Bangladesh Ltd.
- MIDAS Financing Ltd.
- Prime Finance & Investment Ltd.
- Phoenix Finance and Investments Ltd.
- United Leasing
- Uttara Finance Ltd.
- Bay Leasing and Investment Ltd.
- Bangladesh Finance and Investment Company Ltd.
- Delta Brac Housing Finance Corporation Ltd.
- Fareast Finance and Investment Ltd.
- FAS Finance and Investment Ltd.
- GSP Finance Company (Bangladesh) Ltd.
- IDLC Finance Ltd.
- International Leasing & Financial Service Ltd.
- Islamic Finance & Investment Ltd.
- National Housing Fin. and Inv. Ltd.
- Peoples Leasing and Fin. Services Ltd.
- Premier Leasing & Finance Ltd.
- Union Capital Ltd.