CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

Introduction

After analysing the data in the previous chapter, this chapter presents the observations and draws conclusions based on the observations. In this chapter an attempt is made to state:

I. Hypothesis in relation to results,

II. Observations based on the data collected and analysed in the previous chapter,

III. Conclusions drawn from data represented by various tables,

IV. Suggestions to reduce problems faced in preparation of Cash flow statements and to provide better information to users, and

V. Areas for further research.

It would be appropriate to evaluate whether the objectives of the study have been fulfilled. When the research framework was prepared, the objectives that were framed have been mentioned on page 40 in chapter III. The findings relating to the study indicate that the following objectives have been fulfilled:

I. With regards to the main objective, the researcher is of the opinion that the current pro-forma is complete and adequate to a large extent. Therefore, no new pro-forma should be prepared. However,
in order to utilise the present pro-forma to educate the investors, shareholders and analysts certain suggestions have been made in this chapter.

2. To achieve specific objective No. 1, that is "reviewing information drawn from Balance Sheet", the researcher has spent large amount of energy and time. The review was of data gathered from sample. The data had become complex because of non-reconciliation of Cash flow statements prepared, as required by the format. This aspect has been considered of prime significance by the researcher and the significance has been depicted in Annexure V on page 234. This Annexure draws attention to complexity of Cash flow statements.

3. All the rest of specific objectives have been achieved and the proofs regarding them are available in this chapter.

I. Hypothesis in Relation to Results:

The hypothesis was framed on the basis of initial observations regarding the utility of the newly introduced Cash flow statements to be compulsorily submitted by companies listed on the Mumbai Stock Exchange.

The hypothesis formulated before the beginning of this study (please refer to page 67 in chapter III) refers to two aspects:

A) It expresses doubt whether Cash flow statement adds more significant information than what is provided through Balance Sheet.
B) The deficiencies in Cash flow statement can be stated after investigation.

♦ The first aspect has been proved. This research has shown that Cash flow statement provides the following significant additional information:

1. Cash flow indicates how the operations of a period affect Cash flow statement. It indicates even if there is profit there is possibility of reduction in cash.

2. It indicates the details of differences between operating profit and operating Cash flow.

3. Cash flow indicates the relationship between operating activities and financing activities. As it is indicated, when the results of operations are negative, companies have no alternative but to raise finance.

4. Analysis of Cash flow statement gives the opportunity to assess the relationship between the Cash flows from each of the three principal business activities i.e. operation, investing and financing. Cash flow indicates the effect of combined activities of operating and financing. It enhances the liquidity.

5. Cash flow indicates the relationship between profit and loss and negative or positive results from operations.
6. Cash flow indicates the relationship between liquidity and cash from operations. It indicates the effect of operations on the changes in liquidity.

♦ The second aspect of the hypothesis has also been proved. The following deficiencies have been noticed:

1. As there is no standard method used in preparation of Cash flow statement, it contains so many variations. So Cash flow suffers from clarity.

2. One of the significant conclusions that can be drawn regarding the deficiencies of Cash flow statement is, Cash flow does not contain an "explanatory statement". As the data indicates, on an average about 32% of balances have been reconciled through combination and permutation and these items sometimes confuse users. So including "notes to Cash flow" can help to understand Cash flow statement. Those companies that have not been reconciled would be required to provide notes to the Cash flow to improve the utility of the Cash flow.

3. One more of the significant conclusions that has emerged out of this study reveals that companies need accounting information system for classifying the heads of accounts according to the format prescribed for Cash flow statements. Any mistake in classification of accounts in Cash flow statement would lead to wrong results and affect the quality of information of Cash flow statements.
4. Non-cash transactions, which may have significant effect on predicting future operating Cash flows, should be disclosed additionally.

II. Observations:

Observations in this chapter are based on results of collected and analysed data in chapter IV. These observations are of two types:

i. Observations regarding reconciliation of Cash flow statements,

ii. Observations regarding additional information provided by Cash flow statements.

i. Observations regarding reconciliation of Cash flow statements:

a) Analysis of the results presented in table 4.2 i.e., classification of contents of Cash flow year-wise, indicates that the number of unreconciled items has increased quantitatively i.e. in percentage basis, it has increased from 12% to 16%. This means that in the duration of two years, unreconciled items have increased by 33%. If in any financial statement the information does not add to knowledge, the analyst would face a very grim situation.

b) Study of the results presented in table 4.2 also indicates that there are many variations in the interpretations of the phrases used in Cash flow statements. So there is a problem in reconciliation of balances.
c) Analysis of the results presented in table 4.3 i.e., classification of directly reconciled balances indicates that out of the five different sources of information, two are related to Balance Sheet and Schedules of Balance Sheet, two are related to Profit & Loss account and Schedules of Profit & Loss account and one source is Notes to Balance Sheet.

Profit & Loss account and Schedules of Profit & Loss account help in directly reconciling the Cash flow to the maximum extent. In the first year 1995-96, the percentage is 53%. In second year it has improved to 57%, and in the third year it also improved to 58%.

If similar effort is made to identify the utility of information content in Balance Sheet and Schedules of Balance Sheet in the first year, that is 1995-96, the percentage is 45%. In the next two years it has decreased to 41%.

As regards the third source of Notes to Balance Sheet in the first year the percentage is 3% in the second year it is 2% and in the third year it is 1%. Thus, the overall conclusion that can be drawn from this table is information from Profit & Loss account and Schedules of Profit & Loss account can be meaningfully utilised to reconcile balances in operating activities in Cash flow statements, thereby utilising the information more significantly. Hence, information in this set is more meaningful to understand Cash flows.

d) In the same table, similar exercise is conducted to combine information available from these three different sources referred to as investing activities and financing activities. It is noticed that
meaningful information for reconciling these balances directly are available through Balance Sheet and schedules to Balance Sheet as compared to Profit & Loss account and Schedules to Profit & Loss account. Therefore, information from Profit & Loss account and Schedules to Profit & Loss account appears to be comparatively insignificant from this point of view.

e) Analysis of results presented in table 4.4. i.e. classification of different ways of combination and permutation for reconciling balances, indicates that over the period of three years the reconciliation of balances through the combination and permutation has a consistent order in the different parts of Cash flow statements. It means investing activities with 30% in the year 1995-96 and 1996-97 and 31% in the year 1997-98 have the highest number of balances, which have been reconciled through combination and permutation. After investing activities, the two other significant parts of Cash flow which have the largest number of balances that have been reconciled through combination and permutation, are financing activities and working capital.

f) Analysis of results presented in table 4.4.2 i.e., investing items reconciled through combination of information in Balance Sheet & Profit & Loss account, indicates that in investing activities there are four items which for reconciling need combination and permutation of data available in both the financial statements i.e. Balance Sheet and Profit & Loss account. These four items are sale of fixed assets, sale of investment, interest received and dividend received. It means meaningful information for reconciling these four items is available in Balance Sheet and Profit & Loss account. In the two
first years, just these four items cover 97% of the items of investing activities, which need combination of both financial statements. This percentage in the year 1997-98 goes up to 98%.

g) Analysis of results presented in the table 4.4.3 i.e., after working capital changes and before extraordinary items reconciled through combination and permutation of information in Balance Sheet and Profit & Loss account indicates that in this part of Cash flow statements there are two items which for reconciling need the information of Balance Sheet and Profit & Loss account. And these two items i.e., interest paid and direct tax paid, cover more than 85% of balances in this part in each year. Thus the information of Balance Sheet and Profit & Loss account can be meaningfully utilised to reconcile balances.

h) Analysis of results presented in the table 4.4.4 i.e., working capital items that are reconciled through combination of information in schedules of Balance Sheet, indicates that there are four items in working capital changes in Cash flow statements which for reconciling are heavily dependent on information in schedules of Balance Sheets. These four items i.e. trade payables, trade receivables, loans and advances and other current assets in the year 1995-96, cover about 89 balances out of 98 balances, about 91%, in working capital which are dependent on schedules of Balance Sheets. This percentage in the next two years decreases to 88% and 86%.

i) Analysis of results presented in the table 4.4.5 i.e., financing activities items reconciled through combination and permutation of
information in the schedules of Balance Sheets, indicates that in the financing activities there are seven items, which are dependent on the information of schedules to Balance Sheet for reconciling. However, this has reduced in three years in percentage from 85% to 77%.

j) Analysis of results presented in the table 4.4.6 i.e., investing activities reconciled through combination of information in schedules of Balance Sheet, indicates that there are two items in investing activities i.e. purchase of fixed assets and investments which cover more than 68% of the items. This percentage increases to 70% in the next two years.

k) Analysis of results presented in the table 4.12 i.e., classification of unreconciled balances activity-wise, indicates that operating and investing activities are two areas of Cash flow statements which have most problems in reconciling balances. However, the financing activities in Cash flow statements have less number of unreconciled balances but the trend in data shows this is increasing as its percentage has increased from 13% to 17%. It means there is 31% increase during three years.

l) Analysis of results presented in the table 4.12.1 i.e., classification of unreconciled balances in operating activities year-wise, indicates that in operating activities the area of problem is related to working capital changes, as it consists of 48% of unreconciled balances of operating activities in the year 1995-96. This percentage has increased from 48% to 51% in the third year. It means during the last three years, companies have not improved presentation of Cash
flow statements and the problem is not reduced. In operating activities, working capital changes and after working capital and before extraordinary items, cover more than 65% of unreconciled balances.

m) Analysis of results presented in table 4.12.2 i.e., classification of unreconciled balances in investing activities year-wise, indicates that most problems for unreconciled balances in the investing activities are related to fixed assets. 48% of unreconciled balances in the year 1995-96 is related to purchase and sale of fixed assets. However, this percentage has reduced to 44% in the year 1996-97 but it has increased to 49% in the subsequent year. It indicates the information which was disclosed in Balance Sheet and Profit & Loss account is not sufficient for reconciling these items. So it needs special attention for disclosing proper information for reconciling.

n) Analysis of results presented in the table 4.12.3 i.e., classification of unreconciled balances in financing activities year-wise, indicates that in financing activities the diversification in the items is very much. However, the number of unreconciled balances in this part has increased during the three years, but these unreconciled balances are spread over different particulars and items.

o) Analysis of results presented in the table 4.13 i.e., percentage-wise unreconciled balances of companies in Rupees value, indicates that the quality of unreconciled balances in the form of Rupee amount is very significant in working capital and investing activities in Cash flow statements. For most companies, the values of their
unreconciled balances under these two headings are about 76%-100% of their activity under that head. It means the amount of unreconciled balances under these two heads is also significant.

The result of this table is to confirm the observations of table 4.12.1 and 4.12.2. Indeed, these three tables indicate that working capital and investing activities are two significant areas of the problem in reconciling Cash flow statements.

ii. Observations regarding additional information provided by Cash flow statements:

a) Analysis of results presented in the table 4.5 i.e., relationship between profit and loss and changes in cash, indicates that even if there is profit there is possibility of reduction in cash. This may be because the number of profit-making companies has decreased from 81 to 74, and out of this on an average 61% of the companies had seen increase in cash. It means that the rest of the companies had seen reduced cash.

b) Analysis of results presented in the table 4.6 i.e., the relationship between operating activities and financing activities, indicates that when results of operations are negative, companies have no alternative but to raise finance. However, the statistics in this table has produced evidence that in spite of positive results obtained from operations, the companies have raised finance but there is no specific trend indication.
c) Analysis of results presented in the table 4.7 i.e., relationship between negative results from operations and profit and loss, indicates that the results relating to profit and loss are evenly balanced.

d) Analysis of results presented in the table 4.8 i.e., relationship between positive, results from operations and profit and loss, indicates that when the results from operations are positive it leads to consistent profitability.

e) Analysis of results presented in the table 4.9 i.e., relationship between changes in liquidity and cash from operations, indicates that when liquidity has increased due to operations, it has maintained its trend in subsequent years. Therefore, the conclusion that can be drawn is, improvement in operations has a multiplying effect and it leads to maintaining continuous liquidity in business.

f) Second part of the same table reveals that when operations are affected, it decreases liquidity in business and the trend continues in subsequent years. This leads us to the conclusion that affected operations reduce liquidity, and it is difficult for companies to change the trend in a short time.

g) Analysis of results presented in the table 4.10 i.e., classification of different activities that change the liquidity, indicates that change in liquidity occurs through the three different activities. These changes occur from individual activity or a combination of activities.

h) In analysis of the results of reclassification of information related to reconciled and unreconciled companies, it is observed that the Cash
flow statement of reconciled companies are more reliable. In unreconciled companies there is doubt whether the information is classified under correct major headings.

III. Conclusions:

Reconciliation of Cash flow statements with financial statements in the annual reports has helped to draw the following conclusions. Reconciliation has also helped to gather more meaningful information.

General Conclusions

1. Cash flow statements prepared by a large number of the sample studied, had followed the format prescribed by Stock Exchange of Mumbai. Cash flows were apparently reconciled (overall), however, there were differences noticed in activity-wise and sub-activity-wise classification.

2. Reconciled Cash flow statements are more dependable. Reconciled Cash flow statements indicate that these companies might have well-established Accounting Information System.

3. Unreconciled Cash flow statements:

   a) Unreconciled Cash flow statements are less dependable. As in these companies, through current information disclosed in Balance Sheet and Profit & Loss account, it was not possible to reconcile the items of Cash flow statements.
b) Analysts, investors and shareholders will have to reconcile the Cash flow statements first to draw meaningful information.

c) In unreconciled Cash flow statements the probability is that inflows/outflows have been wrongly classified under the three major heads of Cash flow statements.

4. Problem areas in unreconciled Cash flow statements are working capital and investing activities. These two areas need the information from Balance Sheet as well as Profit & Loss account for reconciling most of their items.

Specific Conclusions:

1. Cash flow from operation is very significant from the point of view of changes in liquidity:

   - If liquidity has increased due to operations, improvement in operations will have a multiplying effect on liquidity and it leads to maintaining continuous liquidity in subsequent years.

   - If liquidity has decreased due to operations, companies will face difficulty for changing the trend in a short time.

2. If Cash flow from operation is negative:

   - Will it lead to profitability?

   - Will it lead to financing?

It is possible that the companies may be able to show overall profit for the year/years under review in spite of loss from operations. Such companies may also take to financing. In the context of the
sample under study, there were four such cases. (please refer to Annexure VII on page 314.)

IV. Recommendations:

The purpose of Cash flow statement is to give more information to users to assess the ability of the enterprise to generate cash and cash equivalents and the need of the enterprise is to utilise those Cash flows. The following suggestions are based on the data studied and observations noted:

1. If Cash flow statement has to provide qualitative conclusions, analysis of quantitative data would not come to help but specific qualitative information may be helpful. This means that, companies providing specific Cash flow trend through the information have to be studied, otherwise the results would be contradictory and confusing. The ultimate conclusion of this thesis is that there is no point in collecting large sample for obtaining qualitative results relating to additional information provided by Cash flow. For obtaining qualitative results relating to additional information provided by Cash flow statement, there is need to have small sample but for a large duration. Trend of Cash flow for many years may provide more useful information.

2. In addition to the Cash flow statement prepared according to the requirements of the Mumbai Stock Exchange, companies should provide the same information in simplified form. In order to illustrate this point the model available is from the annual accounts
prepared by "Grasim Industries Limited". The relevant extract is reproduced from the annual report 1999-2000 below:

Such information is included in the above annual report under the heading management’s discussion & analysis on page 18.

“Cash flow Analysis:

<table>
<thead>
<tr>
<th>Source of Cash</th>
<th>1999-2000</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Crores)</td>
<td></td>
</tr>
<tr>
<td>Cash from operations</td>
<td>669</td>
<td>76.4</td>
</tr>
<tr>
<td>Income from investing activities</td>
<td>51</td>
<td>5.8</td>
</tr>
<tr>
<td>Reduction in working capital</td>
<td>156</td>
<td>17.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>876</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

**Use of Cash**

- Net capital expenditure: 265 (30.3%)
- Net investments: 89 (10.2%)
- Reduction in debt: 156 (17.8%)
- Interest: 281 (32.1%)
- Dividend (including corporate tax on dividend) for 1998-99: 57 (6.5%)
- Increase/(Decrease) in cash and cash equivalents: 28 (3.1%)
- **Total**: 876 (100.0%)

Additional information has been provided in the form of notes to Cash flow statement.

**Source of Cash**

- **Cash from operations**

Cash from operation has gone up by 20% from Rs.557 Crores in 1998-99 to Rs.669 Crores in 1999-2000. This is attributed to improved volumes and higher contribution from the fiber, cement and sponge iron businesses during the year.
• Income from investing activities

Income from investing activities primarily consists of dividend, interest and other income at various divisions. The inflows declined by 26% to Rs.51 Crores in 1999-2000 owing to lower interest receipt on income tax refunds during the year.

*Use of Cash*

• Capital expenditure

The company incurred a net capital expenditure of Rs.265 Crores in 1999-2000. This was towards setting up a new cement plant with an installed capacity of 900,000 TPA at Reddipalayam in Tamil Nadu and towards maintenance capex as well as modernisation undertaken at various units.

• Investments

The company investments are to the tune of Rs.89 Crores during the year. Of this a sum of Rs.3.3 Crores were invested in other companies of the Aditya Birla Group viz., Birla AT&T Communications Limited and Bina Power Supply Company Limited. These investments were in line with commitments made by the company in the past. The balance amount was invested in short-term liquid investments by the company.

• Reduction in debt

The company raised Rs.680.5 Crores and repaid a sum of Rs.836.9 Crores during the year. This included pre-payment of high cost debt to the tune of Rs.327 Crores and refinancing of the same with debts bearing lower coupon rate. Following a net reduction in debt of Rs.156 Crores, the company’s debt equity ratio came down to 0.82 by the end of 1999-2000.

• Net working capital

Net working capital requirements declined by Rs.156 Crores on account of effective inventory and better Cash flow management.
• Dividend

The company has paid Rs.57 Crores towards dividend for 1998-99. For the year 1999-2000, the company has announced an interim dividend of Rs.6 per share and has proposed a final dividend of Rs.1 per share. Including the corporate tax on dividend, the outflow on account of dividend payment would be Rs.72.2 Crores for 1999-2000 as compared to Rs.62.7 Crores for 1998-99.

This would be useful for shareholders because after reading this, shareholders can have a better idea of the Cash flow statement.

3. In the sample studied by the researcher, there were three annual reports which were accompanied by Notes to Cash flow statements. The details are given below:

<table>
<thead>
<tr>
<th>No.</th>
<th>Name of Company</th>
<th>Year</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Sadhana Nitro Chem Ltd.</td>
<td>1995-96</td>
<td>33-34</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1996-97</td>
<td>31-32</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1997-98</td>
<td>33-34</td>
</tr>
<tr>
<td>II</td>
<td>Tamil Nadu Newsprint &amp; papers Ltd.</td>
<td>1995-96</td>
<td>35-36</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1996-97</td>
<td>35-36</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1997-98</td>
<td>37-38</td>
</tr>
<tr>
<td>III</td>
<td>Bharat Forge Ltd.</td>
<td>1995-96</td>
<td>56-60</td>
</tr>
</tbody>
</table>

These three companies who have notes to their Cash flow statements have been reconciled and it was easy to understand the balances in Cash flow statements. Bharat Forge has not included such notes in the years 1996-97 and 1997-98.

Apart from these three companies, there are seven other companies who have prepared explanatory notes to their Cash flow statements. These explanatory notes were helpful in reconciling balances.
4. Usually Cash flow statements do not contain any explanation regarding changes that have occurred in Cash flows due to abnormal situations. However, one of the recent annual report of ICICI (1999-2000) has given explanations regarding mergers, amalgamations, acquisitions, etc. through a consolidated Cash flow statement and explained some contents of the changes that have occurred. To clarify this point relevant matter is reproduced:

“Supplementary schedule of non-cash investing and financing activities:

Business Combinations

ICICI Limited purchased the entire capital stock of Anagram Finance Limited (Anagram) for Rs.167 million with effect from April 1, 1998. Similarly ICICI Limited purchased the entire capital stock of ITC Classic Finance Limited (ITC) for Rs.167 million with effect from April 1, 1997. In conjunction with these acquisitions, liabilities were assumed as set out below:

<table>
<thead>
<tr>
<th></th>
<th>Anagram</th>
<th>ITC</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year ended March 31</td>
<td></td>
</tr>
<tr>
<td>Fair value of assets acquired</td>
<td>14,044</td>
<td>9,631</td>
</tr>
<tr>
<td>Fair value of liabilities assumed</td>
<td>13,867</td>
<td>(10,398)</td>
</tr>
<tr>
<td>Excess/(deficit) of fair value assets over Fair value of liabilities</td>
<td>177</td>
<td>(767)</td>
</tr>
<tr>
<td>Common stock issued as consideration</td>
<td>167</td>
<td>167</td>
</tr>
<tr>
<td>Goodwill/ (Negative goodwill)</td>
<td>(10)</td>
<td>934</td>
</tr>
</tbody>
</table>

The goodwill is being amortised over a period of five years. The negative goodwill has been adjusted against the values assigned to non-current, non-monetary assets on a proportionate basis.”

The relevant Cash flow aspects of such transactions are likely to affect the Cash flow statement and reconciliation of Profit & Loss account and Balance Sheet.
5. To reduce the difficulties in reconciling the items of Cash flow statements, there is need of installing proper accounting information system to prepare Cash flow statements as per the prescribed model of the Mumbai Stock Exchange.

6. The researcher has devised a flow-chart to reduce problems of reconciling balances, i.e., the process that should be followed to prepare the Cash flow statement according to the format –seven main phrases contained in it. If companies deviate from these phrases because these phrases do not suit them in classifying the balances of inflows and outflows, balances in certain accounts are transferred under different headings. The ultimate Cash flows would get reconciled but not under the seven specified headings.

V. Areas for Further Research:

As preparation and disclosure of information in the form of Cash flow statement is a new aspect in India, this field of research clearly justifies substantially more research attention for Indian academics. The present research is a modest attempt in this direction and seeks in the concluding part to highlight areas for further research. However, there are many aspects of the Cash flow statements that clearly warrant further research attention, but topics given below are only representative and they have emerged out of the present study as side issues to be tackled. For any researcher who has interest in this aspect of disclosure of information there is immense scope for further research.
1. For studying relevance of Cash flow statement for researcher in decision making one could focus on developing procedures and techniques for improving the format and contents of Cash flow to enhance its usefulness in decision making.

2. As analysis of Cash flow statements is based on the three aspects of operating, investing and financing activities, there is need to study for redefining the definition and classification of operating, investing and financing. This could reduce the problem of reconciliation.

3. For obtaining qualitative results relating to additional information provided by Cash flow statement, there is need to cover a small sample but in a large time span. Trend of Cash flow in a large time span, may help studying in greater details the changes in trend and provide additional information relating to the utility of information of Cash flow statements. The consistency of information revealed could be checked through such an exercise.

4. Further research could focus on developing procedures and techniques for developing the usefulness of applying Cash flow information to different ratios for assessing the flexibility and liquidity of specific companies.

5. It appears from this research study that there is need for an accounting information system in order to facilitate preparation of Cash flow statements and make it easier to understand its contents. Designing accounting information system for the above area could be an area for further research.
6. Unreconciled Cash flow statements can be studied from the point of view of the effect of inaccuracies that affect the results. To what extent it affects the results could be an area for further research.