RESEARCH ARTICLE

A study of the disclosure level of Cash Flow Statement

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Abstract:
This study empirically investigates the factors influencing the disclosure level in Sri Lankan companies and provides evidence of factors associated with the level of disclosure requirement. The factors examined were, company size, profit after tax, cash and cash equivalents, cash flow from operating activities, investing activities and financing activities of the statement of cash flow. For this purpose, a disclosure index was developed representing the provisions given in Lanka Accounting Standard (LKAS)-07; Statement of cash flow. Annual reports of eight public companies in the plantation sector were examined against the disclosure index. The data gathered were statistically analyzed by refereeing to the content of disclosures. The findings of this study indicate that Sri Lankan companies have better disclosure level. The analysis indicates R-square value of 0.55 for overall disclosure level, despite the fact that independent variables show a low R-square value. Therefore, the level of disclosure can be regarded as favorable in terms of information needs of various interested parties of the companies.

Key words: Disclosure Cash flow statement, Stakeholders

Introduction

Accounting is the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by interested parties. The definition of accounting implies of having two stages, identifying and measuring economic information and communicating economic information. The latter aspect of accounting process is accomplished by financial reporting and by maintaining consistency. It could be defined as the communication of financial and related information of an entity to its various stakeholders, particularly the external parties. Therefore, the term financial reporting does not include only the information communicated through financial statements. Thus, financial statements are a central feature of financial reporting, among the many means of communicating information, about an organization to its stakeholders. On the other, framework for the preparation and presentation of financial statements helps improve the quality of financial information. The framework of accounting is created for achieving the objectives of financial reporting. This framework is a theoretical endeavor with the practical aim of clarifying the objectives of financial reporting, and how alternative practices are likely to achieve those objectives. On the other hand regulatory framework includes Government legislation, Accounting Standards, Stock Exchange Regulations and Tax laws. Framework for the preparation and presentation of financial statements provides the conceptual foundation for these regulations. Framework needs to assist in the development of new standards and review of existing standards and to assist auditors assessing an opinion, as to whether financial statements confirm with Lanka Accounting Standards (LKASs) to assist in promoting harmonization of regulation, accounting standards and procedures relating to financial reporting.

Sri Lanka has a strong legislative and institutional framework governing accounting and auditing practices of firms, which represents an assortment of government intervention and self-regulation to prepare financial reports in a way of proper standard. Sri Lanka's accounting and auditing systems have been directly influenced by the British systems due to the British rule in Sri Lanka and more recently by international practices, particularly the international accounting and auditing standards .Accounting standards deal mainly with financial measurement and disclosures used in producing a set of fairly presented financial statements. They draw boundaries within which acceptable conduct lies. The financial reporting process and its ultimate objective, disclosure, are guided to a greater extent by the legislative and institutional framework governing accounting and auditing practices of the entities.

Each accounting standard provides disclosures according to the relevancy of the standard.

American Accounting Association (AAA) defines disclosures 'as the movement of information from the private domain into the public domain'. Both financial and non-financial disclosures are included. According to the Sri Lankan context there are mandatory disclosures and voluntary disclosures. This study discusses the mandatory disclosures of the LKASs. Mandatory disclosures highly assist all stakeholders in each company towards the decision making, with regards to the company. Stakeholders have different kinds of informational needs. But all these needs cannot be fulfilled through the information that are reflected from the annual reports.

Though, they are recommended as mandatory disclosures, there is a difference in the level of disclosure among the companies. This is due to the type of industry, company size, leverage, liquidity, profitability, type of auditor and company age[1].

This study was narrowed down for the Conceptual Framework related to Financial Reporting, LKAS 01-presentation of Financial Statements and LKAS 07-Statement of Cash flows. According to the Sri Lanka Accounting Standard, LKAS 01- of cash flows, accounting policies and explanatory notes practices are included. Accordingly, while the comprehensive income statement and statement of financial position are usually presented as the two major financial reports, the cash flow statement is considered necessary to provide a more complete representation of an entity's financial position and operating performance. The framework of financial reporting is different from one country to another country. Hence, the disclosure requirement level is also different for each country. As such we cannot predict the disclosure requirement of a country by using the research based on another country.

Though Accounting Standards present the theoretical background for financial reporting, there are deviates between accounting theory and practices. The disclosure level of annual reports mainly focused on the stakeholders of the company. Employee group, equity investors including existing and potential, loan creditor group, the analyst, business contacts, the government and the public can also be identified. The problem statement of this study is, " what is the existing level of disclosure level". By addressing the above problem the following objectives were identified, since even with the current disclosure requirement level [1], satisfying the informational requirement of stakeholders, there are still unsolved questions about disclosure level in annual reports. The objectives, therefore, in the current study were (a) to measure the disclosure levels in plantation sector in Sri Lanka, (b) to identify the deviates of accounting standards practice and (c) to see to what extent Sri Lankan listed companies comply with the LKASs.

Methodology

This study measures level of disclosures by referring to mandatory requirements as per LKAS 07. Therefore, the study basically focuses on the cash flow disclosure requirement. LKAS requires cash flows to be mainly categorized into three activities namely, cash flows from operating activities, cash flows from investing activities and cash flows from financing activities. Therefore these activities are taken as variables of this study and the level of disclosure is measured there on.

Population and Sample

The study population comprised of companies, listed on the CSE as at 31st March 2012. According to the CSE website, total number of companies listed on the CSE is 287. These companies are categorized into 20 industrial sectors. In the process of sample selection, except plantation sector companies, other sectors were excluded. Therefore, in this research only plantation sector companies were included and the sample was limited to 8 companies.

Sample period and data collection

All data used to develop the model of this study were secondary data extracted from audited annual reports published in CSE website for the financial year 2011/2012. The selection process was done by using purposive sampling method.

Variables

The variables used were operating activities, financing activities and investing activities. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows from normal business activities during the accounting period. 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 entity. 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. Content analysis was used to measure these variables. Content analysis is a technique for making replicable and valid inference from data to their context[2]. Using this technique, the amount of information disclosed can be measured per category by counting the data items.

Development of Disclosure Index
Disclosure index refers to the degree or level of disclosure made by each company calculated by dividing the number of actually disclosed items in the company's annual report by the required applicable items or the number of average items disclosed by the company. The equation used to calculate the disclosure for each company is

DI=AD/AvD.

Where:

DI=the disclosure index for a company.
AD=the number of items a company actu ally disclosed.
AvD=the average number of items for the sampled companies.

Using this procedure, a disclosure level index was computed for each item in the checklist for all the companies. The total disclosure level was calculated using the equation.

$$DL = \sum (x_1 + x_2 + x_3 + ...x_n)$$

Conceptual Framework
The following is the conceptual framework to show the operationalization of the study variables. Cash flow disclosure consists of three main components namely operating, financing and investing activities (Figure1). Aggregation of these disclosures under three activities determines the cash flow disclosure. Cash flow disclosure is a part of overall disclosure level. Therefore, from the relationship between cash flow disclosure and overall disclo sure, one can identify the disclosure level of each company. Further it is assumed that the disclosure level is controlled by the company size, profitability, cash and cash equivalent.

Research Model
In this study, content analysis (Anatomy analysis) and E-views 6 versions, a statistical computer application package was used with multiple regressions to analyze the impact of disclosure level and the firm variables. The following regression models were to be fitted to the data in order to assess the effect of each variable on the disclosure level.

$$DL_{Op} = a + \beta 1\ Size + \beta 2\ PAT + \beta 3\ CCE$$
$$DL_{In} = a + \beta 1\ Size + \beta 2\ PAT + \beta 3\ CCE$$
$$DL_{F} = a + \beta 1\ Size + \beta 2\ PAT + \beta 3\ CCE$$
$$DL_{T} = a + \beta 1\ Size + \beta 2\ PAT + \beta 3\ CCE$$

Where; DLOp = Disclosure level of operating activities, DLIn = Disclosure level of investing activities, DLFn = Disclosure level of financing activities α=Constant, β1 Size= Size of the company (Total Assets), β2 PAT= Profit after Tax, β3 CCE= Cash and Cash equivalents, DLop= Disclosure level of operating activities, DLIn= Disclosure level of investing activities, DLFi= Disclosure level of financing activities, DLT= Overall disclosure level.

Results and Discussion

This represents the regression results related to the independent variables of operating activity, financing activity and investing activity in determining the level of disclosure. Size, profitability and cash and cash equivalents are the dependents of independent variables. Table 1 reports regression results of the study that

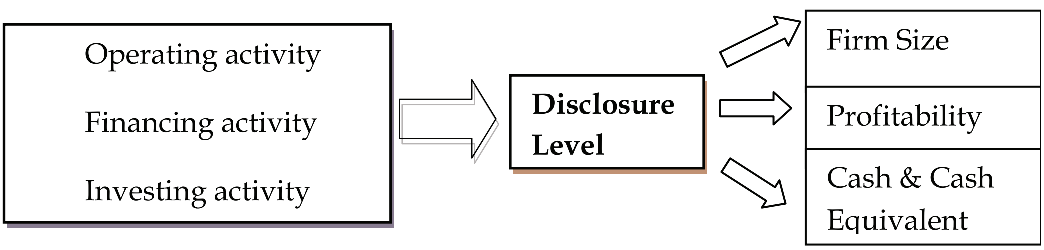

Figure1. Conceptual framework

represents good model to some extent. The multicollinearity shows that there is no material relationship among independent variables. This does not hold statistically significant relationship. The coefficients of size, profitability and cash and cash equivalents indicate that the size of the company is positively associated with the disclosure level of operating activities but statistically insignificant. Both variables of profitability and cash and cash equivalents are negatively associated with disclosure level and also statistically insignificant.

Table 1. Regression analysis for operating activity model

Variable	Coefficient	Probability
CCE*	-2.60	0.84
PAT⁺	-1.50	0.32
Size!	14.10	0.34
R-Square	0.20	
Multicollinearity	1.19	

*Cash and Cash equivalents, ⁺Profit after Tax, !Size of company

The output of the regression analysis in relation to investing activities is given in Table 2. The R-square value indicates that it is not a strong model. However, the multi co linearity indicator shows that there was no strong interrelationship among the independent variables. The coefficients of cash and cash equivalents and profit after tax indicate that both cash and cash equivalent and profit after tax are positively associated with the disclosure level, though not statistically strong. With respect to the size of the company, the coefficient and significance levels imply that investing activities and size of the company are negatively associated with each other, even though the relationship is statistically insignificant.

Table 2. Regression Analysis for investing activity model

Variable	Coefficient	Probability
CCE*	12.82	0.36
PAT⁺	0.69	0.63
Size!	-3.52	0.80
R-Square	0.18	
Multicollinearity	1.35	

*Cash and Cash equivalents, ⁺Profit after Tax, !Size of company

With respect to the regression analysis of disclosure level in relation to financing activities, the R-square value was not significant. The multicollinearity is sufficient value to test the data. The coefficient and significance level of cash and cash equivalents indicates that cash and cash equivalents is positively associated with disclosure level, but still statistically insignificant. Profitability and size of the company show a negative association. However the association is statistically insignificant. The results of the regression analysis in relation to financial activities are given in Table 3.

Table 3. Regression analysis for financing activity model

Variable	Coefficient	Probability
CCE*	15.15	0.3750
PAT⁺	-0.16	0.9272
Size!	-5.72	0.7458
R-Square	0.24	
Multicollinearity	0.20	

*Cash and Cash equivalents, +Profit after Tax, !Size of company

The regression model for overall disclosure model generates a R-square carrying a high explanatory power. The R-square (0.55) is considered to be satisfactory and supported by similar studies[3,1]. The multicollinearity among dependant variable was 2.12.

Table 4 reveals that coefficients of the size and cash and cash equivalents are overall disclosure level. However this positive association with overall disclosure level was not statistically significant. Earlier studies[1,4,5].also have revealed that there was a positive association between company size and the level of disclosures. With respect to profitability, the coefficient and significance levels were - 0.97 and 0.59 thus showing a negative but insignificant association with the overall disclosure level. However, it was noted that profitability had a positive association with the disclosure level of investing activities. Overall, analysis reveals that company size and cash and cash equivalents (liquidity position) are positively associated with overall disclosure level compared to other models which were tested in relation to disclosures on cash flows from each type of activities.

Table 4. Regression Analysis for Overall Disclosure Model

Variable	Coefficient	Probability
CCE*	25.38486	0.1601
PAT+	-0.968172	0.5872
Size!	4.853576	0.7808
R-Square	0.549703	
Multicollinearity	2.127751	

*Cash and Cash equivalents, +Profit after Tax, !Size of company

Conclusion

The results reveal that the average disclosure level by all the companies tested were above the standard level of disclosure requirement in relation to each of operating, investing and financing activities When the average overall disclosure level was considered, it was found that the actual disclosure level was more than the required standard level. This reveals that companies have adequately disclosed the information pertaining to all the aspects of cash flows. Data analysis revealed that company size and cash and cash equivalents are positively associated with the disclosure level though profit after tax, is negatively associated with the disclosure requirement level in relation to operating, investing and financing activities. When considering the individual activities, there is some variations with company size, profit after tax and cash and cash equivalents. Overall disclosure level is adjusted as discussed above. Furthermore,when considering the separate independent variables in the model, no indication was found to attributes of a satisfactory model. However, the overall disclosure level model showed qualities of a satisfactory model but the model is statistically insignificant. However these findings were in par with the findings of similar studies[1,3].

In conclusion, it can be stated that plantation sector companies have a satisfactory disclosure level but it does not imply the attributes of a better financial reporting in Sri Lankan companies listed on the CSE.

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