Cash flow Accounting and Reporting

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Abstract: *In today's business environment, it is not enough simply to monitor earnings and earning per share measurements. An entity's financial position and especially its inflows and outflows of cash are also critical to its financial success. Financial statements aim is to assure an efficient dialogue between the company and the external operators interested in having a good perspective of the entity. The statement of cash flows is a compulsory financial statement, which provides information about a company's cash inflows and outflows over a period of time. This information helps predicting a company's future cash flows and thus facilitates investment and credit decisions to be made. This Article is based on the features, advantages, usefulness, and various models of Cash flow Accounting and Reporting and the practice followed and instruction for its preparation for the guidance of the students and accountants. The paper also focuses on the regulatory framework of cash flow reporting in India and abroad. The paper also emphasizes to bring a suitable change in the Companies Act of different countries to have a "Cash Flow Statement" as a part of the final accounts.*

Key Words: *financial statements, cash inflow, cash outflow, sources of cash, application of cash*

1. INTRODUCTION:

It has been emphasized that accounting has to be tuned with social and economic environment of a country. The role of accounting has been changing with the growth in the social, economic, political and legal environment. It has to play an important role in measurement and communication of necessary information to different groups of users of accounting reports to enable them to make rational decisions. But the traditional accounting is not playing such type of useful role and this is not really helpful in investment and other types of decision. The traditional account depends much on subjective judgments for allocation and valuation purposes for determining business income. The impact of subjectivity on business income is considerable and not negligible, so it cannot be ignored. The items in which subjectivity involves are:

- Method of depreciation, depletion and amortization;
- Valuation of investment;
- Treatment of Goodwill;
- Profit on Incomplete Works;
- Valuation of Fixed Assets;
- Treatment of expenditure during construction;
- Treatment of retirement benefits;
- Conversion of foreign currency items;
- Treatment of Contingent Liability.

Earnings per share (EPS), return on capital employed (ROCE), and price earnings ratio (P/E Ratio) are commonly used as measures of corporate performance. Actually, the base of these ratios is "net profit after tax", which may differ from firm to firm due to wide range of flexibility provided by Generally Accepted Accounting Principles (GAAPs), and there involves the subjectivity on account of above items. Thus, it becomes clear that earnings per share, return on capital employed, and price earnings ratio cannot be correct measures of corporate performance.

Now, the cash flow per share (CFPS) appears to be a better measure than earnings per share (EPS) and "operating cash flow to capital employed" for measuring corporate profitability. This measurement may be possible if "Cash Flow Basis of Accounting" is maintained. Overall, Cash Flow Basis of Accounting can be taken as an alternative measure for reporting the corporate performance. Actually, the cash flow accounting avoids the subjectivity associated with the above factors and it concentrates on the liquidity and financial management of the reporting entity; and can be conceived in terms of both actual and forecast cash transactions. This system presents information which appears to be vital for the survival and growth of the enterprise.

Among the emerging dimension, "Cash Flow Accounting" has recently attracted a wider attention. The development of Cash Flow Accounting as a complete system goes to the credit of G. H. Lawson and T. A. Lee. T. A.

Lee advocates "Cash Flow Accounting" and opines that "Cash flow profit" is far less subjective than traditional profit. Harold M. Williams, the then Chairman of the Securities and Exchange Commission (SEC) of U.S.A., opined that "Cash flow operation" was a better measure of performance than earnings per share.[1]

The Study Group established by the American Institute of Certified Public Accountants stated in its report published in 1973, "An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flow to them in terms of amount, timing, and related uncertainty.[2] Thomas A. Lee also identified three common needs of the users of accounting information:

- Each group is concerned with how well the company has survived in the past and how well it is likely to survive in the future;
- Each group is concerned with making and monitoring decisions. Each of these decisions has financial consequences, and suitable information is needed to aid the decision-makers;
- There are common features to be found, the main one being that each group is concerned with the most basic resources in business – Cash. [3]

2. HISTORICAL BACKGROUND:

Liquidity crisis being faced by number of corporations in United Kingdom and U. S. A. led to the development of Cash Flow Accounting and Reporting. A. L. Thomas, an eminent research scholar of U. S. A. got published his research paper entitled "Allocation Problem in financial accounting theory" from American Accounting Association in 1974. He recommended abandonment of conventional income statement for measurement. He suggested the preparation of "Statement of net quick assets" which should be supplied by the corporations while doing financial reporting but he could not develop any uniform model or reporting format. He emphasized only on income statement and ignored position statement and finally suggested that the position statement should be prepared with allocation-free data.

Yuji Ijiri, best known for development of historical cost accounting, got published his article, "Cash flow accounting and its structure" in Journal of Accountancy, Auditing and Finance in May, 1978. He suggested that reporting should be made by preparing statements reflecting investment flows and financing flows. He also suggested for determination of "Cash recovery rate".

Cash recovery rate can be determined with the help of two variables: (i) Net Profit + Depreciation + Interest + Fixed Assets Sales; and (ii) Gross investment made before depreciation. Ijiri could not develop pure cash flow accounting model. His concept can be regarded as an extension of Historical Cost Accounting.

Lloyd C. Heath, another eminent author of U. S. A. has written his monograph No. 3 entitled "Financial Reporting and the Evaluation of Solvency" for AICPA in 1978. This monograph was highly critical of relevance of Fund Flow Statement to the decision making of users generally and in the evaluation of enterprise solvency in particular. Heath supported the repudiation of the Fund Flow Statement and introduction of Cash Flow Statement. Heath was of the view that external users like creditors and investors are more interested to evaluate corporate solvency and liquidity rather than earning capacity of reporting entity. He suggested preparation of statement of cash receipts and payments. Heath was of the view that statement of cash receipts and payments should be prepared coupled with further two statements; which are –

i) Statement describing Changes in assets on the asset side of Balance Sheet;
ii) Statement describing Changes in liabilities on liability side of Balance sheet.

G. H. Lawson initiated debate on the issue in England in 1968. He has done a number of studies and researches for development of cash flow accounting in England. He was first who made valuable suggestions. He suggested preparation of statement of cash flows and cash forecast. Lawson also suggested preparation of statement indicating variance between cash flows forecast and actual cash flows. He developed his own and concrete model on cash flow accounting which is accepted worldwide.

Tom Lee, another notable accounting researcher in England, has done a tremendous work for the development of cash flow accounting in England. He has written a number of research papers in this field. He found that cash flow accounting data are more useful to most external users groups but particularly to bankers and lenders assessing corporate liquidity. Lee was also of the view that Cash Flow Accounting is also useful for internal management system. He has developed a concrete model for Cash Flow Accounting and suggested that Cash Flow Accounting can be linked with NRVA.

3. LITERATURE REVIEW:

Madill, Haines, Riding, (2003) Suppliers of risk capital tend to be more specialized in growth-oriented businesses than lenders' loan account managers. Typically, they also provide assistance with the Commercialization process.

Jayaraj and Ilango (2004) examined the determinants of textile exports in India during the period from 1981-81 to 2001-02. The study concluded that the trade openness was the major factor than raw materials, power, obsolete machines, technology up-gradation and demand in determining the exports of textile goods.

Balakrishnan (2005) in his study, "Financial Performance of Public Sector Petroleum Industry", analyzed the liquidity, solvency, profitability and predicted the financial position of the companies. He concluded that the petroleum industry is in a healthy position.

Chalam and Prasad (2006) attempted to evaluate financial performance of primary agricultural co-operative societies in Andhra Pradesh, through scaling technique. The study concluded that out of nine co-operative societies, four societies' performance were poor.

4. CASH FLOW ACCOUNTING: CONCEPT

Cash flow accounting is the need of changing accounting environment. It is a new style to present the true financial performance of an enterprise. This system constitutes the analytical framework for linking past, present and prospective financial performance. It is a system which describes the financial activities and performance of an entity in purely cash terms. It is free of credit transactions and arbitrary accounting allocation.

Barry E. Hicks provides a good definition of “Cash Flow (Basis) of Accounting” as follows:

> *The ‘Cash Flow Basis of Accounting’ means recording not only the cash receipts and disbursement of the period (the cash basis of accounting) but also the future cash flows owed to or by the firm as a result of selling and transferring title to certain goods.*[4]

In the words of Tom Lee (1981) “Cash Flow Accounting is ……..conceived as a multipurpose reporting system compatible with the decision and accountability aims usually associated with conventional allocation- based reporting system. The Cash Flow Basis of Accounting goes beyond ‘real’ cash flows, including the current value accounting concepts of ‘future’ exit value (cash flows) for an asset and the ‘future’ replacement value (cash outflows) to replace asset. [5]

The Cash Flow Accounting is suitable to displace profit from its central role as a measure of business performance in Corporate Reports. However, this does not carry any implications that cash flows are unsuitable for other roles, and in particular, it is recognized that cash flows might usefully replace the working capital approach to fund flow statement.

The Cash Flow Accounting takes care the changes in prices and thus prevents distortion in financial reporting. In the context of industrial sickness, the issue of cash flow accounting assumes added significance as the “cash losses” is the main indication of industrial sickness of an industrial unit. The cash flow accounting is the recent proposal in the accounting area to improve the relevance and utility of external financial report. It is used as an essential element in managerial decision making control e.g., in capital budgeting and working capital management.

The technique of cash flow analysis (cash flow accounting) when used in conjunction with ratio analysis, serves as a ‘barometer’ in measuring the profitability and financial position of business. It is claimed that the Cash Flow Accounting, besides taking care of the most of the shortcomings of the “General Purchase Power Accounting” (GAAP), and “Replacement Cost Accounting” (RCA), provides good indicator of liquidity and performance.

5. FEATURES OF CASH FLOW ACCOUNTING:

Cash Flow Accounting provides a means of reducing the ownership emphasis which is inherent in the Profit Statement. It has been predominantly advocated as flow statement with relatively little attention devoted to the consideration of an interrelated position statement. Cash Flow Accounting can contribute much in improving the utility of corporate financial reports due to its ‘report potential’. This system has many features which have mainly been identified by Lawson and Lee. These are:

- Cash Flow Accounting avoids dubious accounting allocation and thus it provides relatively unambiguous measures of entity’s financial performance;
- It reflects the impact of inflation on business more accurately;
- It is the only proper basis for measuring the value of entity as going concern because of its attention to the time value of money. It is thus capable of providing not only the present value of investments but also rate of return which conforms with the time value of money;
- Cash Flow Accounting is capable of providing data which are needed for a variety of decision and control activities both within and without the reporting entity;
- Cash Flow accounting as a system of financial reporting is objective, understandable and simple. It avoids subjectivity and language of accounting allocation and present the data in a way that is potentially recognizable to its users; and
- Cash Flow Accounting emphasizes some of the most fundamental vital features of business activity; the ability of the enterprise to pay obligations, makes distribution, and provide for its future continuity.

6. CASH FLOW ACCOUNTING: MODELS OR SYSTEMS

Different authors like Thomas A. Lee, G. H. Lawson, William Ferrara, R. H. Giles and Barry E. Hicks have suggested different cash flow accounting models keeping the objectives in view that the financial statements should be prepared in such a manner that the investors, creditors, managers and others are able to predict future cash flows.

T. A. Lee in his model considered the various elements which are:

- Manufacturing and /or Trading Transaction Flows: Cash inflow (revenue received) and outflows (expenditure paid) relating to the operational activity of the company is considered. It excludes any exceptional or relatively non-currents items. The items which includes are namely, collection from debtors, wages and other cash expenditures.
- Exceptional or Non-current Transaction Flows: Cash inflow and outflow relating to the company's operational activity which can reasonably be described as either exceptional or relatively non-current are considered.
- Financial Transaction Flows: Cash flows by the company (both received and paid) to its shareholders, lenders and bankers, but excluding interest and dividend payments, are considered.
- Capital Transaction Flows: Cash flow resulting from the purchase and sale of profit contributing resources by the company, including land, building, plant, equipment etc., and shares expended in the area of research and development.
- Taxation Transaction Flows: It considers the cash flows relating to tax payment and refund from the tax authorities.
- Interest and Dividend Transaction Flows: It considers the cash flows relating to interest payments to the lenders and interim and final dividends payments by the company to its shareholders.

He has suggested the preparation of a "Summary Statement of Cash Flows", which is given below:

Cash receipts from sales and customers		***
Less: Cash Payments for operating items		
Manufacturing	***	
Wages	***	
Factory Overhead	***	
Administrative Overhead	***	
Selling and Distribution Overhead	***	
		***
Net Operating Cash Flow (NOCF) or margin		***
Less : Interest on loan paid		***
Pre-tax Cash Flow (PTCF)		***
Less: Taxes paid		***
After-tax (or distributable) cash flow		***
Less: Dividend paid		***
Operating Cash Flow available for investment		***
Add: Receipts from Equity Capital	***	
Add: Receipts from long term borrowings	***	
		***
Total cash flow available for investment		***
Less: Cash payments for new investments and replacement		***
Total increase in cash resources		***

His recent suggested formulation for Cash Flow Accounting is as follows:

$$O - I - T - D + E + B - R = C$$

Where, O = Net Operating Cash Flow;
I = Interest on borrowings;
T = Taxes paid;
D = Dividend paid;
E = Receipt from Equity Capital;
B = Borrowings;
R = Payments for replacement and New Investments;
C = Change (Increase) in cash resources.[6]

Features of Lee's Model are:

- Lee conceived structural framework of cash flow accounting as an interlocking series of statements;
- Lee's system is enterprise oriented;
- Lee has a comprehensive and complete model;
- Lee's model is mainly concerned with provision of cash flow data for variety of user's group.

Tom. A Lee proposed linking of cash flow accounting with Net Realizable Value Accounting and he has given number of arguments in favor of his proposal.

- both CFA and NRVA are based firmly on the importance of cash as a business resources;
- both are allocation-free system;
- the condition of enterprise survival is greatly emphasized in both;
- both concentrate on reporting on the activities of management and organization;
- NRVA and CFA both provides relevant information to the user groups;

He was of the view that linking of CFA with NRVA can be easily achieved by segregating NRVA data into realized cash flows and unrealized cash flows.

G.H. Lawson has suggested a total cash flow financial system for corporate reporting in which "Net Operating Cash Flow" is first computed separately and then entered into the main cash flow statement. He proposed a Statement, which is presented below: [7]

Sales revenue			***
Less:	Cash payments for operating items		
	Materials	***	
	Labor	***	
	Works Overhead	***	
	Administrative Overhead	***	
	Selling Overhead	***	
			***
Net Operating Cash Flow			***
Add/Less:	Bank Balance (Overdraft)		***
			***
Less:	Corporation Tax	***	
	Capital expenditure	***	
			***
			***
Add:	Long term debts		***
			***
Less:	Payments for debts & Interest		***
			***
Add:	External Equity Finance	***	
	Sale of surplus assets	***	
	Tax rebate, if any	***	
			***
Cash Flow Stream available to shareholders			***

Features of Lawson's Model are:

- Lawson's model assumes system as proprietorial in nature;
- Lawson's model is relatively simple to understand;
- Lawson model is mainly concerned with provision of cash flow data to improve informational base of investors and financial managers only.

6.1 Lee's Model vs. Lawson's Model

There are some basic differences in the Lee and Lawson proposal for formulation of Cash Flow Model. Firstly, Lee conceived the structure of cash flow accounting as an inter-locking series of statements for a variety of users. Lawson, on the other hand, is mainly concerned with the provision of cash flow data to improve the information base of investors and financial managers.

Secondly, Lee's system is enterprise oriented, intended for a variety of user group, and concentrates on a reporting of the various cash flow of the entity; Lawson's system is largely proprietorial in nature because of its attention to distributable flows and investors.

William Ferrara has devised a system of financial reporting on cash flow basis which contains a cash flow counterpart to each of the traditional accrual financial accounting statement and also other relevant formats to facilitate recording and presentation of data on different aspects of business operations. Ferrara seeks to demonstrate that cash flow accounting is better equipped to present useful financial information's different aspects, such as annual operating cash flows, return on investment, annual capital charge and capital recovery performance of the business both corporate and segment performance etc. He has suggested the preparation of the following reports. These reports taken together will be a cash flow version of the Income Statement, Balance Sheet and the Fund Flow Statement.

- Annual Operating Cash Flow Reports;
- Beginning-of-year Invested Capital Report;
- Annual Operating Cash Flow ROI Data;
- Annual Capital Charge and Capital Recovery;
- End-of-year Invested Capital Report;
- End-of-year Long Term Financing Data; and
- Annual Cash Summary.[8]

Another proposal has been suggested by Giles, a financial analyst of United Kingdom. He suggested for the computation of net trading receipts as the difference between trading receipts and trading payments. The amount so computed is added with fixed assets sale proceeds and from the total, payments for fixed assets and intangibles are deducted to give 'operating cash flow'. This is the amount of cash available with the business for different payments, such as, income taxes, interest, dividends, loan repayment etc. After deducting these amounts "Net Cash Flow" is calculated. The format of Giles is given below: [9]

Trading Receipts			***
Less:	Trading Payments		***
Net Trading Receipts			***
Add:	Fixed Assets Sale Proceeds		***
			***
Less:	Payments for fixed assets and intangibles		***
Operating Cash Flow			***
Less:	Payments		
	Income taxes	***	
	Interest	***	
	Dividends	***	
	Loan repayments	***	
			***
Net Cash Flow			***

Features of Giles Model are:

- Giles model is easy to understand and simple to present;
- Giles suggested inclusion of sale proceeds of fixed assets and payment for fixed assets and intangibles to determine operating cash flow;
- Giles suggested to show taxes as non-operating item;
- He emphasized to present separate information on interest, dividend and repayment of loans.

7. ARGUMENTS IN FAVOR OF CASH FLOW ACCOUNTING AND REPORTING:

A number of accounting scholars have proposed that "Cash Flow Accounting" be emphasized more than has been common in conventional financial reporting. Lee and Lawson have been prominent among European advocates of cash flow accounting. At present, this system is associated with these two scholars. They have given sophistication to cash flow accounting and argued forcefully for its introduction. Lee argued that cash flow accounting data are useful to most external users or groups interested in companies especially to bankers and lenders concerned with assessing corporate liquidity.

Cash flow accounting data do not appear to cause difficulties to its investors-users despite their lack of familiarity with it. Lee finds that most of the companies in U. K. used cash flow accounting system to a considerable extent for internal management purposes. The utility of cash flow accounting in the area of taxation has been recognized in the report of U. K.'s Meade Committee (1978) in which it has been recommended that company tax in the U. K. be based on measured cash flow. [10] This is the first tangible evidence of its practical utility and importance.

Cash flow accounting and reporting can objectively solve the inflationary and another problem of the firm to maintain its operating capability both from short-term and long-term points of view to treat the business as a going concern.

Lawson submitted a memorandum to the Sandilands Committee proposing switch over to cash flow accounting in inflationary environment. According to him, investor seeks to optimize the cash flow they derive from their investments. The objectives of financial reports, therefore, should be to inform investors the dimensions of the Company's cash flow, thereby providing them with a realistic standard of reference by which to judge the adequacy of its dividend policy. The failure of financial reports in this respect lies in financial accounting procedures which allocates non-current expenses such as depreciation against current income. As a result, accounting income is substantially less than cash flow income. Ultimately, he abandoned "conventional financial reporting" completely in favor of cash flow reports. The argument advanced by the Cash Flowists in favor of the adoption of the cash flow basis of accounting and reporting is the needs of both of those who want stewardship-oriented information and those requiring decision-oriented information.

The Statement of Financial Accounting Concept (SFAC) No. 1 on "Objectives of Financial Reporting by Business Enterprises" issued by Financial Accounting Standard Board (FASB) of U.S.A. in November, 1978 has laid down two primary objectives, viz.,

i) to provide information which is useful to investors, creditors and others in making rational decisions; and
ii) to assist investors and creditors in assessing future net cash flows to the enterprise in respect of amount, timing and uncertainty.

In order to fulfill these primary objectives of financial reporting, there is an urgent need for adoption of Cash Flow Accounting. The reliability of Cash Flow Accounting is emphasized by Barry Hicks clearly in the following words:

The accounts that are needed careful analysis for statement users in the cash account and not the related earnings account since users are interested in the ability of an organization to generate and use cash effectively and efficiently, not 'income' ... The market multiple reflects net free cash flow more closely than earnings.

It is obvious from the above statement of Sir Barry Hicks that users of information are interested to know the true liquidity cash flow. They analyze the ability of an organization through generation of cash and use of cash efficiently and effectively. They ignore income or earnings and like to know cash flow more closely.

Barry Hicks clearly advanced three reasons in favour of Cash Flow Basis of Accounting:

- since investors invest cash in anticipation of receiving back cash flows sufficient to justify their investment, the financial measures they need, are cash flow measures;
- since decisions are always future oriented, the financial measure must be future cash flow measure;
- since only data different among alternatives effect a decision, the financial measures must be measured of future cash flows among different alternatives.

The justification for cash flow accounting can better understood in the following words of Yuji Ijiri:

"There has been a serious discrepancy between the way in which the investment decisions are made and the way in which the results of the decisions are evaluated. In investment decision, the primary factor is cash flow….in the performance evaluation the emphasis shifts to earnings…the two are often not reconcilable. Therefore, either investment decisions should be based on earnings or performance evaluation should be based on cash. The choice is rather obvious, because the primary objective of a business enterprise is cash flow. Earnings are only the surrogate to represent performance of the enterprise on this cash flow objective. And if earnings do not tell how well a project or a division/corporation is doing in terms of cash flow, then the concept and measurement of earnings has to be changed". [11] He recently advocated the use of cash flow accounting as a measure of enabling the results of managerial decisions to be evaluated on the same basis as they were taken.

Heller (1969) states that "business do not earn profit, they earn money." Consequently, "the figure called profit is an abstraction from the true underlying movement of cash into and out of company". For this reason conventional financial reports should be replaced by cash flow reports".[12]

Lee (1972) also argued cash flow accounting and reporting on the ground of objectivity and preferred not to abandon conventional financial reports. Recently, Lee suggested that cash flow accounting are parts of a single system of reporting which concentrates on the importance and accessibility of 'cash' in business enterprise activity. Actually, cash flow accounting could simplify financial statement because 'less disclosure' of accounting methodology would be required. It would be more directly compatible with the needs and abilities of its potential users, particularly those lacking in accounting qualification and experience. [13]

Barry E. Hicks advanced three reasons in favour of the choice of Cash Flow Basis of Accounting:

- since investors invests cash in anticipation of receiving back cash flows sufficient to justify their investment, the financial measures they need, are cash flow measures;
- since decisions are always future oriented , the finance measure must be future cash flow measures; and

- Since only data different among alternatives effect a decision the financial measures must be measure of future cash flows different among alternatives. [14]

8. CASH FLOW ACCOUNTING AND REPORTING: ADVANTAGES

The Corporate Report listed seven characteristics which were required for information to be useful viz., (i) relevance; (ii) understandability; (iii) reliability; (iv) completeness; (v) objectives; (vi) timeliness; (vii) comparability. Cash flow accounting qualifies most of these characteristics, especially by being understandable and objectives.

The advantages attributed to cash flow accounting are numerous. They include the following:

i) A system of cash flow accounting might provide an analytical framework for linking past, present and future financial performance. Thus, it provides information useful to the management, bankers, creditors, suppliers and specialized financial institutions.

ii) Cash flow accounting would rely on the price/ discounted flow ration as a more reliable investment indication than the present price/earnings ratio, because of the arbitrary allocations used to compute the present accrual earnings per share figure and the international differences in the computation of earnings per share.

iii) Cash flow accounting is allocation-free.

iv) In contrast to accrual-based earnings, cash flow accounting retains money as the unit of measurement, which is familiar and confusing to people.

v) Cash flow accounting, when expanded to include projected cash flows, may help the investor to assess the ability of the firm to pay its way in the future and also of the firm to pay its way in the future.

vi) Cash flow does not require price-level adjustments, because each transactions reflect prices of the period in which they occur. It is, however, appropriate to note that some general price-level adjustment is needed for cash plans occurring in different periods.

vii) If the investor’s interest is in the survival of the firm, together with the ability to provide a stream of dividend, then cash flow accounting will prove more useful by providing accounting information about the current and anticipated cash positions of the firm. Liquidity assessment is a critical aspect of performance evaluation in the sense that cash flow and net are the end result of a firm’s activities. [15]

viii) Cash flow information fits as an important variable in the decision models of various users because of the concerns associated with the firm’s ability to pay dividends to investors, interest and capital to lenders and bankers, amount due to suppliers, wages and other benefits to employees, rectification and maintenance services for customers, and taxation to governments. [16]

ix) Cash flow information is argued to be more objective and relevant than accrual based information. According to Lee, first, in its historic form, it is perhaps the most objective information possible, avoiding most of the subjectiveness which enters into the technical adjustments involved in the traditional accrual accounting; it is the most relevant information for purposed of comparison with forecast information should this be measured on a cash basis. Second, forecast cash flows, although involving a great deal of uncertainty (however, no more so than budgeted profits on the accrual basis). Clearly avoid the necessary subjectiveness of accrual judgments and opinions. Therefore, they appear to be far less subjective in a total sense than profit forecasts.[17]

x) There is the suspicion that the popularity of the all-embracing measures of performance such as profit may well have caused firms to under-estimate the importance of performance measures such as market domination, productivity and quality of products and services. [18]

xi) Cash flow accounting is the ideal system to correct the gaps in practice between the way in which an investment is made generally based on cash flows) and the ways the results are evaluated (generally based on earnings.)

xii) The inclusion of cash flow based statements in the package of conventional accounting statements (at least in the initial state) would greatly help their users in the further analysis of the operating performance and financial position of the reporting entity with the help of various cash flow based ratios. These ratios may contain some information not found in profitability ratios.

Naturally, those opposed to cash flow accounting question each of the above advantages, which leave the debate largely in the hands of researchers. However, it is clear from the above mentioned points that may of the important potential benefits of cash flow accounting arise because this method of accounting is allocation-free. A.L. Thomas, who was a prominent exponent of cash flow accounting, stated explicitly that all allocations, which are the basis of accrual accounting, are arbitrary and incorrigible. [19]

9. CASH FLOW INFORMATION: USEFULNESS

The information supplied by the traditional accounting system is suited to stewardship function. But, accounting, now-a-days, is considered to uphold an information system which serves the need of many users group. It

may be mentioned that in many decision areas the information obtained from traditional accounting needed to be adjusted to suit the requirements of management. But, in this regard, cash flow accounting will be of great help. The basic decision areas of financial management where the cash flow information is to be considered suitable are: investment decision, financing decision and dividend decision. Moreover, cash flow information was found relevant for liquidity appraisal, measurement of operational efficiency and profitability. It is also very useful for prediction of sickness and for justifying financial grants for revival of sick units. The segment reporting of cash flow, cash flow from operating activities by multinational firms are of great importance to study the different aspects of economic conditions, identifying the segments contributing cash or having negative cash flows. The techniques of cash flow reporting through Cash Flow Statement also helps the management in knowing the amount of capital tied up in a particular segment of the business. Foster suggested "cash flow operations to sales" and "cash flow from operations to average total assets" for measurement of operational efficiency. Cash flow from operating activities is a better indication then EBIT, since it eliminates unrealized income and non-cash charges. In distress situation, the cash flow ratio, i.e., ratio of cash flow to total debts was found as one of the successful prediction of business failure (Beaver's Study – 1966). Cash to be distributed and to be retained can be better decided using cash flows from operating activities rather than net profit. Value added statement, prepared under cash flow basis avoiding the highly subjective item of deprecation charge, provides proper information about the liquidity of the business undertakings.
E. S. Hendrickson suggested accepting the cash flow information showing the following objectives:

- It helps the investors and creditors to predict the amount of cash likely to be distributed in the future in the form of dividend or interest and in the form of liquidation distributions or repayment of principal;
- It aids in the evaluation of risk;
- Cash flow data are assumed to provide basic information in the evaluation of market price of securities. [20]

10. CRITICISM:

Cash flow accounting, as a financial reporting system to replace the existing accrual system, has generated some criticism among accounting scholars. Some accounting scholars opined that there is great difficulty in using cash flow accounting information to measure the performance of a company specially a company's profitability. Some also argued that the cash flow accounting should not replace the present accrual accounting system. D. A. Egginton opined that cash flow accounting should not replace the present accrual accounting system. He also advised that cash flow data could be given supplementary information for the benefits of the users. His opinion is based on empirical research conducted by him. According to him, profit is central point to performance measurement and cash flow data are not capable of assuming such as informational role. Indeed, he regarded cash flow reporting as having a strictly limited function is the assessment of entity liquidity.[21] According to H.A. Rutherford, cash flow accounting is not allocation free; it involves allocation and measurement problems are cash needs to be distributed between capital and revenue expenditures between different segments and between other activities. [22]

Major objections against cash flow reporting were raised by Sandilands Committee on the ground of the difficulty in forecasting and presenting the future position of cash forecast which is actually an important management too,; the efficiency of management depends on its ability to forecast future cash flows as accurately as possible. Sandilands Committee recognized this and considered it essential that cash flows forecast be prepared for internal purposes but the committee added that they need not be published. It only recommended that cash flow statement for the year should be attached to the accounts.

Finally, it can also be stated that the system of cash flow accounting is too radical for it is to be accepted by either the profession or by business. The Corporate Report, in 1975, ignored the topic completely. However, the Sandilands Committee recognized the potential utility of the cash flow reporting but did not regard the system as being a feasible solution to financial report.

11. REGULATORY FRAMEWORK OF CASH REPORTING IN INDIA AND ABROAD:

The Canadian Institute of Chartered Accountants (CICA) has first pronounced for providing Cash Flow Statement in place of the Fund Flow Statement. The Institute introduced cash flow accounting standard in 1985. The U.S. Professional Standard to this effect came in 1987 when the FASB (Financial Accounting Standard Board) accounting standard entitled "STATEMENT OF CASH FLOW" (SFAS – 95) was promulgated (FASB, 1987). And other countries i.e., Australia, New Zealand and South Africa also followed the CICA and FASB guidelines. The International Accounting Standards Committee has promulgated on Accounting Standard (IAS – 7) on the subject of cash flow reporting (IASC, 1992). The U.K. Standard on the subject promulgated in 1991 entitled Financial Reporting Standard (FRS) – 1. FRS-1 issued in 1991 has been revised in 1996 and the revised standard is effective form March, 1997.

The practice of providing Cash Flow Statement is spreading among the companies of developing countries. The promulgation of International Accounting Standards Committee (IAS – 7) on Cash flow Reporting replacing the

standard on "Statement of Change in Financial Position" has helped a lot in this regard. The IAS – 7 is the standard which has got the official backing from International Organization for Securities Commission (IOSCO).
In India, the initiative to introduce the Cash Flow Statement (as a part of annual accounts) has been taken by the SEBI, which is also a member of the IOSCO. The SEBI has also directed all recognized Stock Exchange in India to provide for a requirement of appending an audited Cash Flow Statement (CFS) as a part of annual accounts. As per the SEBI mandate, the requirement of providing a CFS is mandatory for listed companies from the financial year 1994 – 95. There is no such requirement in the Indian Companies Act, 1956 (as amended up-to-date) to append Cash Flow Statement with the annual financial statement.

When the SEBI mandate was issued, there was no accounting standard issued by the Institute of Chartered Accountants of India (ICAI) as regards the preparation and presentation of a Cash Flow Statement. The ICAI has issued a revised Accounting Standards (AS – 3) on the subject in March, 1997 substantially following the IAS – 7. Cash Flow Reporting in Bangladesh gained a momentum from the mid-seventies. A few progressive and enlightened companies, particularly the multinationals, started the practice. The practice is gaining increasing popularity although in Bangladesh it is not statutorily required to prepare Cash Flow Statement as a primary financial statement. It meets the requirement of the Companies Act, 1994 and helps compliance with Institute of Chartered Accountants of Bangladesh's Standard on Cash Flow Statement (AS – 6). Now-a-days, it is considered as the best practice and is required to meet the information requirement of the investors and creditors. And ultimately, many companies in Bangladesh started the practice of preparing Cash Flow Statement as an integral part of the financial statement. In China, Chinese Accounting Standard Committee (CASC) has issued an Accounting Standard (CAS – 2) on Cash Flow Statement. Till date, in Malaysia, Malaysian Accounting Standards Board (MASB) has issued several accounting standards with a mission to improve the quality of financial reporting in Malaysia. MAS – 5 relating to the preparation of Cash Flow Statement. In Sri Lanka, Institute of Chartered Accountants of Sri Lanka has issued accounting standard (SLAS – 9) on Cash Flow Statement.

12. CONCLUSION:

The basic purpose of corporate financial accounting and reporting is to provide information useful to decision-makers in their economic decisions. Cash flow accounting and reporting aims at providing such type of information. So, it is clear that in order to meet the primary objective of financial accounting and reporting system there is an urgent need for adoption of such cash flow accounting and reporting system. It may be considered as an alternative approach to the existing method of reporting business income. It is obvious that cash flow accounting and reporting has a sound rationale to justify its application as the better performance evaluation.

To-day, this system commands a strong theoretical background, a developed measurement and reporting framework and growing empirical support. In India and other countries, it is necessary to make it mandatory for all companies to annex Cash Flow Reports along with the traditional information. It is desirable to bring a suitable change in the Companies Act of different countries to have a "Cash Flow Statement" as a part of the final accounts.

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