Classification Shifting in the Cash Flow Statement: Evidence from India

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Comments

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The Question

1. Do managers shift investing or financing cash flows to operating cash flows or vice-versa? Even a Yes or No answer is a relevant and important one.
2. The study makes an important contribution by starting the conversation on the topic in India.
3. The study raises many questions, even as it answers the basic initial question.

The Question

1. The mechanics of managing the cash flow is far more complex than managing earnings.
2. Cash flow is derived from the balance sheet, which in turn, is largely influenced by the profit and loss statement.
3. Managing the cash flow would mean substantial management of the profit and loss statement and the balance sheet.
4. The cash flow statement exposes some of the earnings management efforts. So, managing the cash flow is a higher order of “manipulation” and it is therefore very important to understand its mechanics.
5. It would be useful if the elementary mechanics of the management of the cash flow is explained.

India Cases

1. Examples of Indian cases of managing the cash flow statement would be useful.
2. The case of Satyam Computer Services is not relevant to the study. This was not an accounting fraud. It was a business fraud that was played out in the accounts. The accounting firms failed on due diligence, not in detecting accounting jugglery.
3. Pointing out a case is tricky since none are “convicted” or even accused of such practices. Yet, a few glaring examples of apparent of management of the cash flow statement would add tremendous value to the study amongst regulators .

Sample

1. Why were the firms with a change in fiscal year-end removed? This is the cause of the biggest loss (28%) of observations in terms of companies.
2. Companies that change year-endings could be particularly useful in the study.
3. A larger number of firm-year observations (36%) were lost because of lack of operating cash flow variable. This merits explanation. Were these companies with poor financial results?

Variables

1. It would be useful to retain the Prowess variable names also to help replication of results by other Prowess users.
2. Does the variable “Sales” corresponds to the variable “Sales” in Prowess. If it does, then, this excludes “other income”. Is this exclusion by design? Why exclude “other income”? How does this exclusion impact the analysis, because operating cash flows are likely to include “other income”.
3. The use of Altman’s Z-score based on 2002 emerging markets research needs validation with Indian data. If there is work done on this, it may be referred.

Research Design

1. Regarding the model to estimate unexpected operating cash flows as proposed by Deechow, etc.
   Does the literature throw any light on the role of change in receivables in explaining operating cash flows?
2. What determines the choice of using a variable to estimate unexpected earnings as against using it to test the hypothesis? For example, why not use discretionary accruals in the former rather than in the latter?
3. It may be useful to conduct the study separately by including and excluding construction companies. Or, better still separately for manufacturing, utilities and non-finance services.

Miscellaneous

1. Why should the probability of manipulation increase when more number of firms issue cash flow forecasts? (section 2, para 2).
2. What is the justification for winsorizing at 1% and 99%, in terms of the choice of 1 and 99?

The Question

1. Do managers shift investing or financing cash flows to operating cash flows or vice-versa?
   Yes or No is a relevant and important question answered by the study.
2. The study estimates the average shifting . What is the implication of this average? Is it a representative average for firms in the sample?
3. Is the average impacted by large values even after winsorizing?
4. What is important is the proportion of firms that manage cash flows.
5. What kinds of firms do so is also important. Financially distressed firms is a good answer in the direction.

Thank You