

CASHFLOW ACCOUNTING AND FINANCIAL PERFORMANCE OF QUOTED INSURANCE COMPANIES IN NIGERIA

Wokeh, Promise Ikechi

Email:promisingfredd@yahoo.com

ABSTRACT

This work investigates empirically cash flow accounting and financial performance of quoted insurance companies in Nigeria. Ex-post facto research design was adopted and the population of the study is twenty-two (22) insurance companies listed at the NSE as at October 2017 for a period of four years (2013-2016). Data were analyzed using Pearson Product Moment Correlation assisted by statistical package for social science (SPSS). The findings suggest that cash flow accounting factors (operating activities and Financing activities) constrain the likelihood of financial performance of quoted insurance companies in Nigeria. It was concluded that while there is likelihood of a strong positive relationship between Cash flow activities and financial performance of quoted insurance companies. The recommendations are; Corporate Financial managers should appropriately blend their Cash flow activities to earn sufficient profitability without sacrificing liquidity. Accountants and standard setters of corporate insurance companies should enhance the quality of earnings because it usually attracts attention of investors. And finally, regulatory authorities such as IFRSB, FRCN, CBN, NSE, SEC, NDIC, etc, should encourage external auditors of quoted Insurance companies to use cash flow ratios in evaluating the performance of a company before forming an independent opinion on the financial statement.

Key word: Cash flow accounting, operating activities, financing activities and financial performance,

INTRODUCTION

The provision of a vigorous relationship between cash flow accounting and firm performance structure has been of consequential interest to academia's, professional accounting bodies, regulators, Regime and other users such as businessmen, politicians, labor bellwethers (Grandel, 2000: Titnan and Ali, 2008). The perspective about cash flow accounting is reinforced by the fact that accounting is a stewardship process that is historically shaped by economic and political forces (watts, 1978; watts and zimmerman, 1986: Herbert, et al. 2013) that the mode of financial reporting plays a key role in firm performance and ultimately in economic development nationally and ecumenically is a prima-facie denotement of its impact in ascertaining a vigorous investor confidence which is vital to the optimal functioning of financial markets and, consequently to economic development (Herbert, Tsegba, ohanele, and Anyahara, 2013). It can be visually perceived that some industries are more cash intensive than others, it is an acknowledge fact that no business can thrive in the Long-run without developing positive cash-flow for its owners. Engendering a positive cash-flow precisely implicatively insinuates that the firms long-term cash inflows exceed its long-term cash outflows.

Cash flow accounting (CFA) within an organization involves the process of taking into cognizance and monitoring the inflow and outflow of cash. This process is relevant in order to ascertain the liquidity of the firm. As more emphasis is made on liquidity rather profitability. A firm that disclose higher profit does not imply it is efficient in cash management. But for an investor to make informed decision, a better analysis of both the income statement and the statement of cash flow is required. Cash flow is measured over a defined period of time usually monthly, quarterly or yearly, and it represents the change in the cash balance over the time frame defined. A firm's total net cash flow can come from three major sources which are: the operating activities, investing activities and finally the financing activities. But the preparation of the statement of cash flow has encountered some challenges of which some inconsistency in the presentation of information in financial statements.

Efforts at estimating the methods (direct or indirect) for measuring cash flow accounting as stipulated by different accounting standards (IFRS and GAAP) and different researchers have resulted to conflicting results. Also, the issue of timeliness affects the preparation of the cashflow statement because its timeliness depends on that of the statement of financial position and income statement.

The absence of audited cash flow accounting may lead to negative consequences in financial markets it may weaken the ability of different shareholders to assess the future and continuity of the entity. In particular, present and potential investors will be less able to predict future cash flows and future share prices, while lenders will be less able to assess credit risk and predict future repayment of loans. (promise & precious, 2009; Elliot & Elliot 2009; Spiceland, Sepe & Nelson, 2012). Therefore, in a view to address these problems, this study aims at ascertaining empirical the impact of cash flow accounting on firm financial performance of quoted insurance companies in Nigeria.

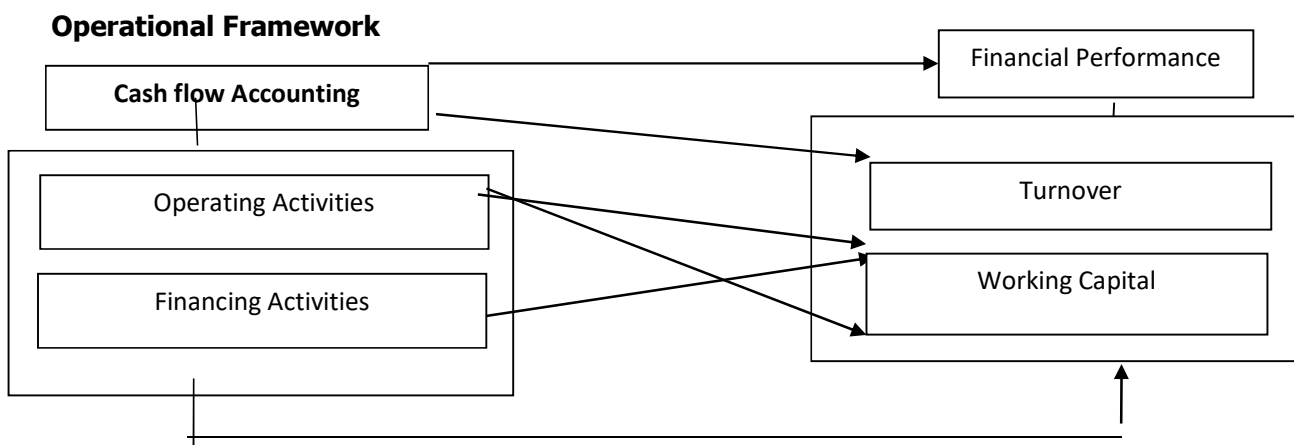


Figure 1: Operational Framework of cash flow accounting and Financial Performance

Objectives of the study are;

1. To ascertain the extent to which operating activities influence the turnover of quoted insurance companies in Nigeria.
2. To ascertain the extent operating activities could relate with working capital.
3. To investigate if financial activities can relate with working capital of quoted insurance companies.
4. To find the extent financial activities could relate with turnover of quoted insurance companies in Nigeria.

Hypotheses are as follows;

Ho1 There is no significant influence of Operating activities on Turnover of quoted Insurance companies in Nigeria.

Ho2 There is no significant impact of Operating activities on working capital of quoted Insurance companies in Nigeria.

Ho3 There is no significant impact of financial activities on turnover of quoted Insurance companies in Nigeria.

H04 There is no significant relationship between financial activities and working capital of quoted Insurance companies in Nigeria.

Theoretical framework

This study is anchor on the following theories namely;

Agency Theory: The agency theory was propounded by Jensen & Mecking (1976). This theory tries to explain the tension that exist between shareholders and managers. There is always a class of interest which results in the agency problem. As opined by Berle & Means (1990), managers of

companies end to pursue a self-interest goal different from that of the organization. Jensen (2006) linked the agency problem, with free cash flows such that management might abuse free cash flows at their authority when investment opportunities were not readily available to the firm. Therefore, free cash flow to management was agency costs to stakeholders.

Accrual Accounting Theory

Under the accrual accounting theory, the accrual accounting base deals with and recognize accounting transactions in the period they are incurred. (IASB, 2000). The transactions are recorded and reported in financial statements of the period they occur whether or not cash has been, received or paid (Riahi – Belkaoui & Jones, 2002). As a result of this development and adoption of accrual base of accounting, the effect of cash and credit transaction are reported adequately in the financial statement for informed decision by investors and management. As opined by Cheng, Liu & Schaefer (1997) Dechow (2004), the adoption of the accrual base of accounting has help immensely to address the timing and matching problem in cash flow statement preparation.

Conceptual framework

Cash Flow Accounting

The cash flow accounting takes into cognizance the preparation of statement of accounting that shows the flow and utilization of cash within an organization. This statement according to IAS 7 is known as the statement of cash flows. It shows the cash inflows and cash outflows of an entity over a given accounting period. It is a component of the financial report prepared by an organization. Cash flow accounting emphasizes the need for a positive cash flow statement to enable the company meet its financial obligations as they are useful indicator of a company's liquidity and solvency. As opined by the Financial Accounting Standard Board (FASB), the aim of the cash flow statement is to ascertain and provide information in regards to the changes in the company's cash or cash equivalent in a given accounting period. The cash flow statement can either be prepared using the direct method or indirect method.

Financing Activities

Financial activities have to do with the portion of cash which the capital providers of the company have received and claimed during the accounting period. These activities comprise of repayment of the returns to the providers of such finances in form of interest and dividend paid as well as expenses directly related to obtaining the finances. As stipulated by IAS 7, cash flows from financing activities include;

"cash proceeds from issue of shares, cash proceeds from issue of debenture, bonds, loan sock, mortgages, short and long-term borrowings, brought down on loans and overdraft facilities including discounting of acceptance, repayment of principal sum or borrowing, payment of interest and dividend, principal repayment of amount borrowed under finance lease and receipt and payment relating to obtaining and repayment of long term credit."

Bragg (2002) opined that financing activities can be seen in two ways either as cash in or cash out i.e. for cash in shares, bonds and debentures are issued out while for cash out a prepayment of interest and dividend.

Operating Activities

Operating activities of the cash flow statement involves the normal trading activities of a company that is activities that has to with the production of goods and delivery of services and other supporting activities. These activities have a direct link on the actualization of the operational profit of the company. Berry, Jarvis, and Jarvis (2005) asserts that the cash generated from operating activities has a direct impact on operational profit of a company. These operating activities of the statement of cash flows include cash receipt from customers and other operating income, cash paid to suppliers and employees and other operating expenses.

Financial Performance

The concept of performance cannot be relegated to mud. It is an essential indicator of the well-being of a company in a competitive environment like that of Nigeria. Performance is important as both managers and shareholder strive for it. Financial performance may be defined as the ability of an organization to accomplish certain objectives. According to Fubara (2004) performance refers to a number of a different aspect. To management, successful means achieving company's objectives, profit, growth, market share etc. satisfying customers' expectations – price, quality, quantity, time etc. and satisfying the needs of workforce – good pay, satisfaction etc. although, performance criteria may differ according to the type of product or service, generally it involves effective use of resources to efficiently convert inputs into the required outputs at the right cost, quality, time and space. Firm financial performance is measured in relation to established organization objectives. Management expert Ducker (1954), Nwachukwu (2005) has stated that objectives should be established in at least areas of organizational performance.

Indicators of Financial Performance

Turnover/ Sales: Reporting turnover is mandatory in respect of companies listed on the Nigerian Stock Exchange (NSE) for financial year ending on or after 30 June. Turnover ratio indicates the efficiency with which the capital employed is related in the business (Uzoma, 2013). The Overall profitability of the business depends on two factors. The rate of return on capital employed and the turnover, i.e, the speed at which the capital employed in the business rotates. Higher the rate of rotation, the greater will be the profitability.

The figures used for the calculation purpose is net sales but for the purpose of this study net premium was used because of the nature of the companies being studied (Insurance companies) which are basically the revenues a company earns. While Turnover ratio are calculated as follows:
Turnover = sales / Average Assets.

Working Capital: Working capital has been defined as a margin (Damilola, 2007), buffer (DeLoof, 2010) or a safety cushion for meeting obligations within the ordinary operating cycle of the business, better still the current assets and current liabilities items available for the day to day running of an organization. (Gupta, 2012). The current assets components of working capital "are assets which can be converted into cash within an accounting year" and consist majority of cash, debtors (account receivable or book debts), short term securities and stock (inventories). Current Liabilities components are claims of outsiders which are expected to be matured for payment within an accounting year and consist of creditors or account payable, bills payable and outstanding expenses. It is the administration of both current assets and current liabilities components that is referred to as working capital (Utensil, 2004).

Empirical Studies

To ascertain the relationship between company performance and cash flow, Ali, et al (2013), carried out a study on the association between various Earnings and cashflow measures of firm performance and stock returns, evidence from Iran. simple and multiple regressions was used to analyze data gotten for a period of 2003 to 2011. From the analysis of data, the study showed that there is significant but negative relationship between company's performance and cash flow.

Thanh and Nguyen (2013) in an attempt to ascertain the effect of Banking Relationship on firm performance in Vietnam used a sample size of 465 companies listed in Vietnam for the period of 2007 to 2010. multiple regression was employed to analyze the data gotten. Therefore, the study revealed that firm performance decreases as a result of increase in bank relationships. The study further revealed that there is a negative relationship of cash flow and firms, return on equity, while assets have negative association with return on assets.

Also, Adelegan (2003) in a view to ascertain empirically the relationship if any that exist between cash flow and divided changes in Nigeria used the ordinary least squares (OLS) method in data analysis. The sample size of 63 quoted firms in Nigeria were selected for a period of 1984 to 1997.

The study revealed that there is a significant and positive relationship between cash flow and firm performance. Furthermore, Farshadfar (1999) in a bid to find out the association of accrual earnings and operating cash flows with stock returns in organizations used statistical linear regression method to analysis data for a period of 5 years. The study therefore revealed that there is no liner relationship between operating cash flows, and operating accrual earnings with stock returns.

Research Methodology

Ex-post facto research design was adopted in obtaining, analyzing and interpreting data relating to the objectives of the study. The population consisted of twenty-two (22) insurance companies listed at the NSE as at October 2017. The sample size of four (4) Insurance companies as listed at NSE was arrived at using the stratified sampling method. the secondary sources of data collected was used for his study which were retrieve from audited annual reports and financial statements of firms for a period (2013-2016). Data were analyzed using a regression model and hypotheses were tested using Pearson Product Moment Correlation computed within statistical package for social science (SPSS).

Model Specification

The following models were stated to guide the test of the hypotheses.

$$Y = \beta_0 + \beta_{1OA} + \beta_{2FA} + \epsilon$$

Where,

Y= Cash Flow Accounting

β_0 = Constant.

β_{1OA} = Operating Activities.

β_{2R} = Financing Activities.

ϵ = error term.

β_{1OA} = Coefficient of Operating Activities.

β_{2FA} = Coefficient of Financing Activities.

ϵ = Error Term.

Therefore, the model adopted for this study is

$$Y = \beta_0 + \beta_{1OA} + \beta_{2FA} + \epsilon$$

Data Presentation and analysis

Table 4.1: Data Collected

Summary of Data collected is shown below:

D e p e n d e n t			I n d e p e n d e n t	
(2 0 1 3 - 2 0 1 6)	TURNOVER	WORKING CAPITAL	OA(₦ million)	FA (₦ m i l l i o n)
Nem Insurance Plc.	37,316,779	24,161,979	1342238.3	- 2 4 3 , 4 2 8 . 7 5
Law Union & Rock Plc.	10,821,134	17,853,014	391,297.75	
Aiico Insurance Plc.	66,055,462	40,637,174	8,090,317.25	- 5 7 3 , 3 9 4
Wapic Insurance Plc.	8,691,086	58,545,837	9 8 , 2 9 5	5 6 6 , 4 3 4 . 7 5

Test of Hypothesis

Ho1 Operating activities do not have significant influence on Turnover of quoted Insurance companies in Nigeria.

Coefficients^a

M o d e l		Unstandardized Coefficients		Standardized Coefficients	t	S i g .
		B	Std. Error	B e t a		
1	(Constant)	-1544747.190	1370917.960		-1.127	.377
	Turnover	.131	.036	.934	3.686	.066

a . D e p e n d e n t V a r i a b l e : O A

Decision: Since $p = .066$ we accept the null hypothesis and reject the alternative hypothesis.

HO2 There is no relationship between Operating activities and working capital of quoted Insurance companies in Nigeria

M o d e l		Unstandardized Coefficients		Standardized Coefficients	T	S i g .
		B	Std. Error	B e t a		
1	(Constant)	33926539.821	13919796.746		2.437	.135
	O A	.553	3.391	.115	.163	.885

a . D e p e n d e n t V a r i a b l e : W o r k i n g c a p i t a l

Decision: Since $p = .885$ we accept the null hypothesis and reject the alternative hypothesis.

HO3 Financial activities do not have significant influence on turnover of quoted Insurance companies in Nigeria

M o d e l		Unstandardized Coefficients		Standardized Coefficients	T	S i g .
		B	Std. Error	B e t a		
1	(Constant)	42846665.590	10071038.506		4.254	.147
	F A	20.748	20.718	.708	1.001	.500

a . D e p e n d e n t V a r i a b l e : W o r k i n g c a p i t a l

Decision: Since $p = .500$ we accept the null hypothesis and reject the alternative hypothesis.

HO4 There is no significant relationship between financial activities and working capital of quoted Insurance companies in Nigeria.

M o d e l		Unstandardized Coefficients		Standardized Coefficients	t	S i g .
		B	Std. Error	B e t a		
1	(Constant)	33389445.118	5641237.677		5.919	.107
	F A	-47.506	11.605	-.971	-4.094	.153

a . D e p e n d e n t V a r i a b l e : T u r n o v e r

Decision: Since $p = .153$ we accept the null hypothesis and reject the alternative hypothesis.

CONCLUSION AND RECOMMENDATIONS

It was concluded that while there tends to be a strong positive relationship between Cash flow activities and financial performance of quoted insurance companies although none of the examined relationships proved significant.

Based on our findings, and conclusions above, the following recommendations were made:

1. Corporate Financial managers should appropriately blend their Cash flow activities to earn sufficient profitability without scarifying liquidity.
2. Accountants and standard setters of corporate insurance companies should enhance the quality of earnings because it usually attracts attention of investors.
3. Regulatory authorities such as IFRSB, FRCN, CBN, NSE, SEC, NDIC, etc, should encourage external auditors of quoted Insurance companies to use cash flow ratios in evaluating the performance of a company before forming an independent opinion on the financial

statement. This will give detailed information on the company to enable investors make rational investment decision.

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