

**EMPIRICAL STUDY ON THE USAGE OF CASH FLOW
STATEMENT AS A TOOL TO PREDICT COMPANY FINANCIAL
DISTRESS**



**INSTITUTE OF RESEARCH, DEVELOPMENT AND
COMMERCIALIZATION (IRDC)
UNIVERSITI TEKNOLOGI MARA
40450, SHAH ALAM
SELANGOR DARUL EHSAN**

PREPARED BY:

**SHARIFUL AMRAN B. ABD. RAHMAN
RUSLAINA BT. HJ. YUSOFF**

ACKNOWLEDGEMENTS

Praise to Allah Al-Mighty for giving us the strength and patience to complete this project paper within the period given.

This project paper would not be possible without the help from many people. I am especially grateful to my co-researcher, Pn. Ruslaina Hj Yusoff, for her wonderful and thoughtful comments, suggestions, guidance and constant encouragement. Her enlightenment and encouragement are greatly appreciated.

I am also indebted to my friends, Nik Rozhan, Rama and Neo for their kindness and ever-willing help given to us through this research.

Finally, I wish to express my deepest gratitude to Pn. Wan Nazihah for her assistance in editing this project paper.

ABSTRACT

This study was carried out to examine whether cash flow can be a good predictor to debt restructuring companies. Sixty companies of Bursa Malaysia (MSE) have been identified as a sample in the current study. Thirty companies were classified as PN4 and another 30 matching companies were classified as non-debt restructuring companies. The classification was done in order to determine the differences between cash flow related ratios such as cash flow changes, cash flow over total debt, cash flow over total assets, cash flow over current liabilities and cash flow per share issued.

The study hypothesized that the means for the cash flow based ratios have no significant difference between debt restructuring and non-debt restructuring companies.

Based on trend analysis, it was found out that generally PN4 companies performed much worse than their counterpart in the matching companies category. Trend analysis and Mann-Whitney U test show that there is significant difference exists between the means for PN4 and non-debt restructuring companies for all the cash flow related ratios except for cash flow changes.

Even though cash flow information is relevant in predicting financial distress, we must take into consideration that the period of the study that could probably affect the results of the study.

TABLE OF CONTENTS

	PAGE
Acknowledgements	i
Abstract	ii
List of Tables	v
List of Figures	vi
 CHAPTER ONE: INTRODUCTION	
1.1 Introduction	1
1.2 Problem Statement	3
1.3 Objectives of the Study	4
1.4 Significance of the Study	5
1.5 Chapter Organization	6
 CHAPTER TWO: LITERATURE REVIEW	
2.1 Introduction	7
2.2 General Overview of Cash Flow	7
2.3 The Relationship Between Cash Flow and Corporate Health	9
2.4.1 Cash Flow and Solvency	9
2.4.2 Cash Flow and Dividend Policy	10
2.4.3 Cash Flow and Creative Accounting	11
2.4 Review of Cash Flow Failure Prediction Studies	12
2.5 Summary of the Chapter	17

CHAPTER ONE

INTRODUCTION

1.0 Introduction

For years, the East Asian countries were admired as some of the most successful emerging market economies. Being the center of the recent crisis, these successful economies are owed to the rapid growth of the countries and the striking gains in their populations' living standards. They were widely seen as models for many other countries due to their generally prudent fiscal policies and high rates of private saving. However, these countries were not foreseen to be involved in one of the worst financial crisis of the postwar period.

In April 1997, the depreciation of the Thai baht triggered a contagious effect on the currencies of Malaysia, Indonesia, Philippines and South Korea, which then resulted the Asian financial crisis. GDP crashed in one country after another and led to a region wide economic downfall. In South East Asia, corporate bankruptcy has reached to an unprecedented level and brings with it economic losses to management, stockholders, employees, customers, and others, together with great social and economical cost to the nation such as the increasing level of unemployment.