

A THEORETICAL INVESTIGATION OF CASH FLOW RATIOS FOR FINANCIAL ANALYSIS

Jooste, L.
Nelson Mandela Metropolitan University

With the introduction of SFAS 95 in November 1987, the cash flow statement became an integral part of the financial statement. Since its proposal the users of financial statements have supported the cash flow statement. Many authors agree on the importance of cash flow for financial analysis but to date neither text writers or analysts have developed a comprehensive set of ratios for the effective evaluation of the cash flow statement.

Ratio analysis is one product of accounting evolution that can be traced as far back as the late 19th century. Since then many ratios have been developed that are widely used by analysts to evaluate financial statements for liquidity, profitability, asset management and debt management.

For many years traditional ratios have been used for financial analysis. Empirical research has shown, as an example, that an entity can have a positive current and quick ratio, yet have severe cash flow problems and in fact, be insolvent. Research has shown the value of cash flow information in a financial analysis.

The purpose of this paper is to investigate recent research to show that traditional ratios are not enough for an effective financial analysis of an entity. A set of cash flow ratios, developed from the cash flow statement, will be suggested that can be used for financial analysis. Such ratios used in conjunction with traditional balance sheet and income statement ratios should lead to a better indication of the financial strengths and weaknesses of an entity.