Does Cash Flow Have An Impact On Profit Quality?

Dr. Khalil S. M. Abu Saleem, Dr. Emad Yousif Ahmed

Abstract: This study aimed to explore if there is an impact of cash flow (index of operational activity, index of operating cash flow, index of return on assets from operating cash flow) on profit quality in Jordanian hotel companies. The study population is composed of all Jordanian hotel companies listed on the Amman Stock Exchange (9), during the period from 2014 to 2018. The study was based on panel data as the data collected one-time and cross-sectional data for a period of time. The data consisted of a set of indicators for 9 Jordanian hotels collected from annual hotels’ reports. The results of the hypothesis test indicate that there is a strong inverse relationship between (index of operational activity, index of return on assets from operating cash flow) respectively, and (profit quality), at the same time the study found that there is an inverse relationship that is not statistically significant between (index of operating cash flow) and (profit quality).

Keywords: Profit Quality, Cash Flow Statement, Operation Activity, Jordanian Hotel.

1. INTRODUCTION

Financial statements prepared by economic entities generally play an important role in decision-making. The cash flow statement is one of those that have a major role to play in these decisions, helping investors, lenders and others in several areas such as forecasting future cash flows, assessing the company's ability to make dividends and meeting investment or expansion requirements. The quality of profits derives its importance from the importance of profits, where the profits of the company are important in the decision-making process in general and investment and financial decisions in particular, and it contributes to the assessment of the financial performance of the entity by the users of these financial statements. Profit quality also reflects the extent to which current profits can generate future cash flows and performance assessment. Lack of interest in the quality of profits may lead to an increase in the uncertainty related to the decisions issued by the company, and vice versa if the interest in the quality of profits, it will reduce the uncertainties. The statement of cash flows is one of the financial statements that are used in the study and evaluation of the monetary position of the economic unit.

1.1 Study Problem

The study problem can be framed by answering the following questions:
1. Is there an impact of the Operational Activity Index scale on the quality of profits of Jordanian hotel companies?
2. Is there an impact on the operating cash flow measurement on the quality of profits of Jordanian hotel companies?
3. Is there an impact of the measure of return on assets from operating cash flow on the quality of profits of hotel companies?

1.2 Study Objectives

Perhaps the most important objectives of the research are:
1. Know the importance of the impact of the Operational Activity Index on the quality of profits of Jordanian hotel companies.
2. Know the importance of the impact of the operating cash flow ratio measure on the quality of profits of Jordanian hotel companies.
3. Know the importance of the impact of the measure of return on assets from operating cash flow on the quality of profits of Jordanian hotel companies.

1.3 Study Hypotheses

In light of the problem and objectives of research, the following hypotheses were formulated:
H01: There is no impact of the scale of the operating activity index on the quality of profits of Jordanian hotel companies.
H02: The operating cash flow ratio measure has no effect on the quality of profits of Jordanian hotel companies.
H03: The measure of return on assets from operating cash flow has no effect on the quality of profits of Jordanian hotel companies.

2. THEORETICAL FRAMEWORK AND PREVIOUS STUDIES

Profits can be divided into cash flow and Accruals receivables (Sloan, 1996). Hence, it is possible to use receivables as a measure of the continuity of profits and thus a measure of profit quality, as the lower the total receivables, this indicates an increase in the quality of profits (Rechardson et al, 2004).

The aggregate receivables model used by Rechardson et al, 2004 was used to measure the absolute value of receivables, through which the continuity of profits will be measured and through continuity we measure the quality of profits.

\[ TACC = \Delta WC + \Delta NCO + \Delta FIN \]

Where:
- TACC: Total Accruals.
- \(\Delta WC\): Change in net working capital.
- \(\Delta NCO\): Change net current operating assets.
- \(\Delta FIN\): Change in net financial assets.

Fridson & Alvarez (P.2002) argues that the statement of cash flows is one of the most significant financial

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statements that are used to identify problems related to the entity’s continuity, as opposed to the income statement and the statement of financial position, which can be manipulated by their respective figures and the impact of decisions and personal judgment. (Taylor et al., 2012) defined the statement of cash flows as “a financial report describing an entity’s economic performance on a cash basis by comparing cash inflows with outflows by excluding forward transactions and estimated accounting allocations, where cash inflows include both Outflows include payments for the replacement and development of investments, where cash flows are considered to be the most important operational activities as they provide indicators in assessing an entity’s financial strength. A company that rarely has a profit management often has a high quality of profit, while companies with a high profit management have a low profit quality, as indicated by Francis et al., 2004 and Jenkins et al., 2006. And (Dechow & Dichev, 2002), where they observed that if profits were free of evidence of their management. A regression model has been developed to estimate these receivables during the cash period through the use of fixed asset size which adjusted the impact of various economic factors and the change in revenue within the cash model. Criticism of this model has been made, but several studies have attempted to avoid most of these criticisms, such as Dechow et al., 1995, which developed the Jones (1991) model by building a set of assumptions and incorporating them into the Jones (1991) model. These assumptions include:
1. All changes in sales on the account during the research period are the result of profit management process, as it is easier to manipulate the process of recognizing sales on the account through management compared to cash sales.
2. The change in machinery, property and real estate controls the level of depreciation of assets.

The development of Dechow et al, 1995 is through the following model:

\[
\frac{\Delta \text{ACC}^{(t)}}{\text{TA}^{(t-1)}} = a_0 \left( \frac{1}{\text{TA}^{(t-1)}} \right) + a_1 \left( \frac{\Delta \text{REV}^{(t)}}{\text{TA}^{(t-1)}} \right) + a_2 \left( \frac{\Delta \text{REC}^{(t)}}{\text{TA}^{(t-1)}} \right) + a_3 \frac{\text{PPE}^{(t)}}{\text{TA}^{(t-1)}} + a_4 \frac{\text{ROA}^{(t-1)}}{\text{TA}^{(t-1)}}
\]

Where:
- \(\text{ACC}^{(t)}\): Total Accruals for hotel (i) in period (t).
- \(\text{TA}^{(t)}\): Total Assets for hotel (i) in period (t).
- \(\Delta \text{REV}^{(t)}\): Change in revenues for hotel (i) in period (t).
- \(\Delta \text{REC}^{(t)}\): Change in accounts receivable for hotel (i) in period (t).
- \(\text{PPE}^{(t)}\): Property, plant & Equipment for hotel (i) in period (t).
- \(\text{ROA}\): Return On Assets for hotel (i) in period (t).

Several studies have unanimously agreed that the performance of the company in the past should be taken into account in the measurement of elective dues, which led many studies to try to develop models used in the measurement of elective dues, which take into account the performance of the company (Dechow et al., 1998).

For this research, the total receivables model used by Rechardson et al., 2004 was used to measure the absolute value of receivables, through which the continuity of profits is measured and through continuity we measure the quality of profits.

The results showed that the standard deviation of the operating activity index was (13.36), which indicates the dispersion of values from the mean, and the mean (3.25). This value is good, as this ratio indicates the ability of the operating activities in the establishment to generate operating cash flows. The average return on assets from the operating cash flow measurement was 0.02, which indicates the ability of the company’s assets to generate operating cash flows. This is a good indicator, depending on the nature of the sample companies, which are hotel companies. Fixed assets are represented primarily by their premises in order to achieve their business continuity and generate profits.

Table (2) presents the results of the descriptive test of the research variable dependent on the quality of profits, through the total receivables, where the greater the total receivables, the lower the quality of the profits and vice versa in the case of the decline in the total receivables, the higher the level of profit quality. It is noted from the table above that 2014 was the lowest in the quality of profits, with the highest average annual total receivables, which amounted to (0.24), the researchers believe that this may be due to the presence of remnants of the effects of the global crisis in that year, while Notice the high quality of profits in other years. Results have shown that the arithmetic mean of the total dues for all years (0.09) as the standard deviation was (0.16).

3. METHODOLOGY

3.1 Study Population

The study population is composed of all Jordanian hotel companies listed on the Amman Stock Exchange (9), during the period from 2014 to 2018. The study sample is represented by all Jordanian hotel companies. Thus the final sample size (9) becomes a company.

Table (1) Descriptive test results for independent research variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational Activity</td>
<td>3.25</td>
<td>13.36</td>
<td>-1.7</td>
<td>99.5</td>
</tr>
<tr>
<td>Operating cash flow</td>
<td>0.07</td>
<td>0.49</td>
<td>-2.2</td>
<td>0.62</td>
</tr>
<tr>
<td>Return on assets from operating cash flow</td>
<td>0.02</td>
<td>0.18</td>
<td>-1.22</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Table (2) Descriptive test results of the research variable of the quality of profits

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>0.24</td>
<td>0.29</td>
<td>0.01</td>
<td>1.03</td>
</tr>
<tr>
<td>2015</td>
<td>0.07</td>
<td>0.110</td>
<td>0.01</td>
<td>0.4</td>
</tr>
<tr>
<td>2016</td>
<td>0.05</td>
<td>0.05</td>
<td>0.01</td>
<td>0.13</td>
</tr>
<tr>
<td>2017</td>
<td>0.05</td>
<td>0.05</td>
<td>0.002</td>
<td>0.15</td>
</tr>
<tr>
<td>2018</td>
<td>0.04</td>
<td>0.05</td>
<td>0.01</td>
<td>0.13</td>
</tr>
<tr>
<td>All Years</td>
<td>0.09</td>
<td>0.16</td>
<td>0.01</td>
<td>1.03</td>
</tr>
</tbody>
</table>

Table 1 represents the results of the descriptive test of the research variable of the quality of profits.
3.2 Sources of Data Collection
The current study is based on panel data since the data combine one-time and cross-section data for a period of time. The data was composed of a set of indicators for 9 Jordanian hotels for the period from 2014 to 2018, and data have been collected from the hotels’ annual reports. The adoption of the study on the analysis of time-series data comes from the increase in degrees of freedom, which leads to more accurate estimation and obtain more accurate results.

3.3 Testing hypotheses:
The first hypothesis Ho1: There is no impact of the index of operational activity index on the quality of profits Jordanian hotel companies.

Table (3): Simple Regression Test Results for the Impact of Operational Activity Index on Profit Quality

Table (3) presents the results of the simple regression analysis of the independent variable (index of operational activity index) and its impact on the dependent variable (profit quality), the results showed that the value of the correlation coefficient is (0.805-), which indicates a strong inverse relationship between statistical The dependent and independent variable, which means that the higher the index of operational activity index, the lower the total receivables, which leads to improve the quality of profits through achieving continuity. Alternative hypothesis, that is, there is a trace of the DL For operational activity in the quality of profits Jordan hotel companies, building on what has been reached in an inverse relationship between the operational activity and benefits guide Index College, where it is the more total del benefits fell on the high quality level of profits. The second hypothesis Ho2: There is no impact of the measure of the percentage of operating cash flows on the quality of profits of Jordanian hotel companies.

Table (4): Simple Regression Test Results for the Effect of Operating Cash Flow Ratio on Profit Quality

Table (4) presents the results of the simple regression analysis of the independent variable (the ratio of operating cash flows) and its impact on the dependent variable (profit quality). The results showed that the value of the correlation coefficient is (-0.335), which indicates an inverse relationship that is not statistically significant between the dependent and independent variable. The operating cash flow ratio does not affect the quality of profits, and therefore the operating cash flow ratio does not have an impact on the profitability of Jordanian hotel companies. The third hypothesis Ho3: There is no impact of the measure of return on assets from operating cash flow on the quality of profits of Jordanian hotel companies.

Table (5): The results of the simple regression test for the impact of the return on assets scale from operating cash flow on profit quality

The results showed that the value of the correlation coefficient is (-0.831) which indicates a strong inverse relationship between the dependent and independent variables, which means that the higher the return on assets from the operating cash flow, the lower the total receivables; During achieving continuity. The results also showed that the significant value was (0.000), the measure of return on assets from operating cash flow affects the quality of profits. Accordingly, the third sub-null hypothesis was rejected and the alternative hypothesis was accepted, ie there is an effect of the measure of return on assets from the flow Operating Cash in Profit Quality for Jordanian Hotel Companies. To prepare the linear regression equation for all search variables, the following table is prepared as follows:

Table (6): Multiple regression test results for linear regression equation for research variables

Note that the level of significance Sig related to the measure of operating cash flows exceeded 0.05, where the value (0.574). Therefore, the variable (X2) was excluded because the Sig level of T exceeded 0.05, indicating the inability to form a multiple regression equation to predict the dependent search variable across all independent search variables combined.

4. CONCLUSION
The study is aimed to know if there is an impact of cash flow in terms of dimensions (Operational Activity, Operating cash flow, Return on assets from operating cash flow) on profit quality.

By testing the hypotheses of the study, the following conclusions were reached:
1. There is a strong inverse relationship between (index of operational activity) and (profit quality), which means that the higher the index of operational activity the lower the total receivables, which leads to improve the quality of profits through achieving continuity. Accordingly, the first hypothesis was rejected and the alternative hypothesis was accepted, which it means there is an effect for the index of operational activity on profit quality.
2. There is an inverse relationship that is not statistically significant between (index of operating cash flow) and
(profit quality), which means that the operating cash flow ratio does not affect the quality of profits, and therefore the operating cash flow ratio does not have an impact on the profitability of Jordanian hotel companies. Accordingly, the second hypothesis was accepted and the alternative hypothesis was rejected, which means there is no effect of the operating cash flow ratio on quality of profits.

3. There is a strong inverse relationship between (index of return on assets from operating cash flow) and (profit quality), which means that the higher the return on assets from the operating cash flow, the lower the total receivables, during achieving continuity. Accordingly, the third hypothesis was rejected and the alternative hypothesis was accepted, which means there is an effect of the measure of return on assets from the operating cash flow in profit quality for Jordanian hotel companies.

REFERENCES


