Finance accounting

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Finance/Accounting

Credit markets as better indicators of bankruptcy than stock markets. It is not more a myth when talking about the credit markets in their role in the development of the financial system of a country. Credit markets in some countries have been proven to generate as much finances as the equity markets and have become as important as equity markets to financial development. Most developing countries concentrate on developing their banking system, who act as the transmitter between the savers and the ultimate consumers of this credit. The bank is considered as the legal means of providing lending and most attention is paid to see how people consume the credits available. Looking at the balance sheet of any particular company and realising that the accounts payable is more than the accounts receivable and all other assets means that the company is at the brink of bankruptcy. (Bodie, 2007)

On the contrary, stock markets do not really reflect that any business is doing fine. This is because, stock markets react to stock market information and this information is what is provided by the accountants of the company. This means that, the company may deliberately exaggerate their financial position just as to get more money and keep the company running (Brealey, Myers, 2006). A case in hand is the ENRON and WorldCom. At the same time, stock markets show an index of some firms, e. g. the DJIA (Dow Jones Industrial Average) is an average of 30 large ‘ blue-chip’ stocks traded on the NYSE (New York Stock Exchange), meaning that it is not a better indicator of bankruptcy for any firm since it is an average of firms operating in the same line of business to show how they are faring on the market. Note that stock

markets value companies based on expected earnings rather than on actual company earnings and this may be misleading.

Cash flow and other financial statements

The cash flow statement shows the amount of cash generated by a business and how this cash generated is used by the business over a forecasted period. Most analysts use the cash flow statement of a company to gauge financial performance of that company. The statement is reflected by adding noncash charges (depreciation) to net income after taxes.

The cash flow statement is different from other financial statements such as the income statement and balance sheet because it does not include the amount of future incoming and outgoing cash that has been recorded on credit. Therefore, cash at hand is not the same as net income, which, on the income statement and balance sheet, includes cash sales and credit sales. 1

The cash flow statement gives a measure by which the true nature of the company can be seen by looking at the core operations of the company, which include the operating aspect, the investing aspect and the financing aspect of the company. But other financial statements does not show al of these. (Stephen, 2007)

It should be pointed here that even though the cash flow statements appears to provide more information than the others, each has a role to play especially as cash on the balance sheet appears as opening cash in the cash flow statement.

References

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