

## Financial Analysis of Nomadic Variables: A Dynamic View of a Financial Manager (A Study of Selected Retail-Outlet Firms in Lagos State)

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### Abstract

*It is often seen that quite a number of expenses do not result in outflow of cash (ie depreciation of fixed assets, amortization of intangible assets:- goodwill, trade mark, patent rights, amortization of deferred expenses:- preliminary expenses, discount on the issue of shares and debentures). As a result, cash generated by the firm is more than the income made by the firm during the year. Analysis of nomadic financial variables demands a careful examination of components of statement of income and statement of financial position as it contain these financial elements of radicals in nature. The radicality of these elements is the outcome of changes in cash flow from operations of the business organization. Their movement has favorable or adverse effect on the financial adaptability of the entity, cash position. The performance of the organization is strictly dependent on the movement of the nomadic. Variables so to say. Figures 1 to 16 shows the luminaries of these nomadic variables, which depicts the accountant's dynamic vision and highlight the values of fund movement.*

**Key Words:** Temporary, most-liquid, technical-insolvency, obligations, liabilities.

### Introduction

For a financial manager of any business organization, the most important function is the proper management of cash to meet the maturing obligations and at the same time, there should be no surplus cash lying idle. Cash is procured by a business from owners and lenders, in both cases at cost. Therefore, the finance manager should ensure that surplus cash, not immediately needed by the business, is properly invested. Again, if Cash is not sufficient to meet the business obligations as and when due, the business may have to face the danger of technical insolvency. Many business organizations, otherwise successful, have failed due to improper cash management. Cash is the most liquid asset which can be used for discharging immediate liabilities, hence, the importance of cash management. Other current assets being less liquid than cash can only be used for discharging liabilities over a period of time, because such assets have to be first converted to cash and then applied for payment of liabilities. From this point, it follows that while funds flow statements are useful for planning long-term operations of the business, cash flow-forecasting statements are useful for planning short-term operations.

**Findings:** The concept of nomadic variables in fund forecasting has revealed that “when all transactions are not cash transactions”, the nomadic financial variables such as credit sales generating debtors, credit purchases generating creditors, inventories of goods prepaid expenses, accrued income, outstanding expenses and income received in advance are having varying degree effects on cash generated from operation of the business organization.

**Problem of the Study:** Cash flow from operations is not only an important source, but also a difficult one to evaluate. But it can be partially understandable when all transactions are cash transactions.

If it is assumed that all sales are cash sales, and all payments (ie for purchases, wages, rent and salaries) are cash payments, then net cash inflow is equal to cash from operation. This implies that payment must have resulted in an outflow of cash, leaving a net cash balance as cash from operation. In this case, net income will result in an equivalent amount of cash resource.

The derivation may be expressed in terms of equivalent equation as:

$$\text{Net cash from Operation} = \text{Net Income}$$

**Objectives Of The Study:** The study sought to conduct a financial diagnosis of the “nomadic variables”, when all transactions are not cash based with the aim of determining how efficient an organization can manage its liquidity and solvency, profitability performance and financial stability in its flow of resources (funds). More specifically, the study sought to:

- (i) Analyse these nomadic variables which do not exhibit a consistent inflow and outflow of resources.
- (ii) Analyse the impact of these financial nomadic variables on organizational performance and profitability
- (iii) Determine the flow pattern of these nomadic variables in forecasting the financial health of the organization.

**Hypotheses of the Study:** The hypothesis to determine the influence of “financial nomadic variables” on organizational performance and manageability of resource flow can be stated as:

**H<sub>01</sub>:** When all transactions are not cash based, financial nomadic variables do not exhibit a healthy flow of resources on the organizational performance.

**H<sub>02</sub>:** When all transactions are cash based, financial nomadic variables do not exhibit the accountant’s dynamic view of professionalism.

**Review of Related Literature:** Cash forecasting is prepared depending on the internal requirements of the business organization.

A properly conceived cash forecast offers the most advantageous solution to the operational efficiency of the entity. It ensures that cash is available at a time it is needed. It enables the management to check the tendency of overspending, as the available resources are known, payments can be tailored to match the resources. Management can decide the form of borrowing after seeing the nature of cash deficit/surplus as revealed by the cash budget. If the deficit is temporary, short-term borrowing such as an arrangement for overdraft with the bank may be sufficient. **Gupta and Radhaswamy (1994)** indicated that the idea of cash-flow statement is to show the impact of various transactions on the cash position of a business organization. It takes into account only transactions immediately resulting in cash-inflows and outflows. In **Shukla-1986**, a cash statement shows the sources of cash receipts and the purpose for which payments are made, explaining the changes in the cash balances of the business organization.

### Methodology:

#### A practical survey of some retail outlet firms in Lagos state metropolis

The study is based on secondary information provided from the audited financial statements of specified retail-outlet firms, which are purchase and sales oriented. The study considered the various transactions in the financial books of these firms, critically looking at the movement of the payables and receivables and other transactions, showing undulating movement. These are considered on analytical context, being discussed in pointwise as:

- ❖ **When all transactions are cash based:** It is assumed that all sales are cash sales and all payments (ie purchases, wages, rent and salaries) are cash payments. Cash sales must have resulted in an inflow of cash and payments must have resulted in an outflow of cash, leaving a net cash balance. In this case, net income must have resulted in an equivalent amount of cash resource. This can be expressed as:

$$\text{Net cash from Operation} = \text{Net Income}$$

This is based on the fact that all transactions are strictly cash based. This condition is hardly satisfied in actual practice.

- ❖ **When all transactions are not cash based:** It is found that a part of sales in the books of the firms under consideration are credit sales, some purchases are credit purchases a few expenses are outstanding to some extent, all incomes do not realize immediately. Under this condition, the NET INCOME made by these firms

cannot generate equivalent amount of cash. All these are taken up one after the other for a comprehensive analyses and understanding of the financial nomadic variables and their radical movement.

- ❖ **Effect of credit sales (a nomadic variable):** It is noted that out of the sales of one hundred million naira from the firms under-consideration, thirty million naira are locked up with customers on account of credit sales and all the payments (ie purchases, wages, rent and salaries) are cash payments resulting in outflow of cash of fifty-six million naira. It will be seen that although income remains the same ie forty four million naira, because credit sales do not reduce the income, hence, cash generated from the operation is reduced from forty four million naira to fourteen million naira. It should be clear to the reader that net income need not generate equivalent amount of cash. The above discussion can be viewed as:

	₦'m	
Cash inflow from sales	(₦100m – ₦30m)	70
Less: Cash outflow from:	₦'m	
Purchases (cash)	30	
Wages (cash)	20	
Rent (cash)	01	
Salaries (cash)	05	
	56	
Net Cash inflow		14

The whole philosophy can be expressed in terms of the equation below:

**Fig. 2**

$$\text{Net Source} = \text{Net Income} - \text{Debtors at the}$$

**Fig. 2**

Corollary to the above rule is that the amount of debtors appearing in the opening statement of financial position is added to the net income made during the year. This is based on the assumption that the debtors outstanding at the beginning of the year are collected during the year resulting in cash inflow in addition to cash inflow on account of net income less debtors at the end of the year. The equation of net income from operation is restated as:

$$\text{cash from operation} - \text{Net income (-) debtors at end (+) debtors at beginning}$$

We can derive a simpler rule for the purpose of determination of cash from operation, if debtors at the end are less than the debtors at the beginning, the cash from operation will be more than the net income by the amount of decrease in debtors:

	₦'m	
Net Income for the year	70	
(+) Debtors at the beginning	30	
	100	
(-) Debtors at the end	20	
Cash from Operation	80	

OR

	₦'m	
Net income for the year	70	
(+) Decrease in the debtors (N30m – N20m)	10	
Cash from Operation	80	

$$\text{Cash from Operation} = \text{Net Income} \text{ OR } + \text{Debtors at the beginning}$$

**Fig. 4**

OR

<p>+ Decrease in debtors</p> <p>Cash from Operation = Net Income OR</p>
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**Fig. 5**

- ❖ **Effect of opening and closing stock of inventories (Nomadic variables):** Opening stock of inventories as it appears on the debit side of Income statement reduces income made during the year without reducing the cash balance. On the other hand, closing stock of inventories increases the income made during the year without increasing the cash balance. Therefore, cash generated from the income can be determined by adding opening stock of inventories to and deducting the closing stock of inventories from the net income. Cash from operation can be taken as a starting point:

	₦'m
Net income	25
(+) Opening Stock	5
	30
(-) Closing Stock	8
Cash from Operation	22

Instead of adding opening stock to and deducting closing stock from the net income, the increase in stock can be deducted from the net income to determine cash from operation:

	₦'m
Net income	25
(-) increase in stock (₦8m – ₦5m)	3
Cash from operation	22

When increase in stock is deducted, the decrease in stock is added to determine the amount of cash from operation:

<p>+ Decrease in stock</p> <p>Cash from Operation = Net Income OR</p>
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**Fig 6**

After taking into consideration the combined effect of credit sales, and stock balances, the cash from operation can be determined as:

<p>+ Decrease in stock</p> <p>+ Decrease in debtors</p> <p>Cash from Operation = Net Income OR</p>
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- ❖ **Effect of credit purchases (A nomadic variable):** Purchases made during the year are shown on the debit side of income statement account. purchases reduce the income made during the year. If all the purchases are cash purchases, to that extent. Cash is reduced if some purchases are on account of credit purchases, then cash of the business is not reduced to that extent. In order to determine cash from operation, the payment outstanding as on the last date of the financial year on account of credit purchase is added to the

net income made during the year. Since outstanding payments on account of credit purchases are shown as creditors in the closing statement of financial position, it can be said that cash from operation can be determined by adding creditors at the end to the net income made during the year. Opening creditors are paid during the year, resulting in outflow of cash without reducing the income made during the year. Hence, cash from operation is determined by deducting the creditors at beginning from net income and adding the creditors at the end.

**Fig 8**  
**Survey of retail-outlet firms under consideration (with effect of nomadic (variables)**  
**Given:**

**Income Statement**  
**(for the year ended December, 2019)**

	₦'m		₦'m
Opening Stock	8	Sales	300
Purchases	232	Stock at end	15
Gross Income	75		
	315		315

**December 31, 2020**

Cash from operation = Net Income (+) closing creditors (-) opening creditors

**Deducing the impact of Nomadic variables**

Net come (as above)	₦'m	75
Less: Increase in Stock (₦15m – ₦6m)		7
		68
Add: Decrease in debtors (₦17m – ₦6m)		11
		79
Less: Opening Creditors		10
		69
Add: Closing Creditors		13
		82

Instead of adding closing creditors to and deducting opening creditors from the net income, the increase in creditors ₦3m is added to the next income to arrive at net income from operation, which can be derived by applying the model:

+ Increase in creditors

Cash from Operation = Net Income OR

Considering the EFFECTS of stock, debtors and Creditors, the cash from Operation can be determined as:

+ Decrease in Stock

+ Decrease in Debtors

+ Increase in Creditors

Cash from Operation = Net Income OR

**Fig. 10**

❖ **Effect of outstanding expenses (a nomadic variable)**

The balance of expenses outstanding account is considered to adjust the income made during the year for determination of cash from operation. Opening balance of expenses outstanding is deducted from and the closing balance of expenses outstanding is added to the income made during the year. This is based on the logic that liability on account of opening balance of expenses outstanding is paid during the year and this reduces the cash generated from operation. The closing balance of expenses outstanding is added to expenses paid account to determine the expenses for the purpose of income statement account. This reduces the income made during the year. This is still outstanding, it does not reduce the cash balance. It is added to the income made during the year. The point is that, all expenses outstanding in the beginning of the year are deducted from and those at the end are added to the income made during the year. This is stated as:-

+ Increase in outstanding expenses
Cash from Operation = Net Income OR

After considering the effects of stock, debtors, creditors, and outstanding expenses, cash from operation can be restated as:

+ Decrease in Stock
+ Decrease in Debtors
+ Increase in Creditors
+ Increase in O/s expenses
Cash from Operation = Net Income OR

**Fig. 12**

❖ **Effect of expenses paid in advance (a nomadic variable)**

Expenses paid in advance is treated in the same logical way as debtors. Expenses paid in advance at the end of the year does not reduce the income determined on accrual basis but reduces the cash balance. It is, therefore, deducted from the income made during the year. likewise prepaid expenses at the beginning of the year will increase the cash balance without reducing the net income. This is because, this amount represents current expenses paid during the previous year. Hence, the opening balance of prepaid expenses account is added to the net income made during the year. This can be stated as:

**Fig. 13**

After considering the effect of stock, debtors, creditors, O/S expenses, and prepaid expenses, cash from operation is determined as:

+ Decrease in prepaid expenses
Cash from Operation = Net Income OR

<p>+ Decrease in Stock</p> <p>+ Decrease in Debtors</p> <p>+ Decrease in Prepaid expenses</p> <p>+ Increase in Creditors</p> <p>+ Increase in O/s expenses</p> <p>Cash from Operation = Net Income OR</p>
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**Fig. 14**

❖ **Accrued income and income received in advance (nomadic variables)**

Accrued income is a current asset item. It is treated the same way as debtors. Decrease in accrued income is added to and increase in accrued income is deducted from the income. Income received in advance is a current liability. It is treated the same way as creditors. Decrease in income received in advance is deducted from and increase in income received in advance is added to the net income made during the year.

After considering the effect of stock, debtors, creditors, outstanding expenses, prepaid expenses, accrued income and income received in advanced, cash from operation can be determined with the model:

<p>+ Decrease in Stock</p> <p>+ Decrease in Debtors</p> <p>+ Decrease in Prepaid expenses</p> <p>+ Decrease in accrued expenses</p> <p>+ Increase in Creditors</p> <p>+ Increase in O/s expenses</p> <p>+ Increase in come rec- inadvance</p> <p>Cash from Operation = Net Income OR</p> <p>- Increase in Stock</p>
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**Fig 15**

A critical examination of these nomadic variables reveals that the figures (tables 1 to 15) consist of two components drawn from statement of financial position, namely floating assets and floating liabilities items. For this reason, Fig 15 can be restated as:

<p>+ Decrease in current asserts</p> <p>+ Increase in current liabilities</p> <p>Cash from Operation = Net Income OR</p>
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**Fig. 16**

**Conclusion:**

Cash/fund flow is the function of a financial manager, its determination has numerous great impact on organizational performance, which entails professionalism and competency. It plays a vital role in the firm's adaptability to changes.

**Recommendations**

- ❖ Movement of liquidity is the dynamic view of an accountant.
- ❖ A firm should be able to establish a pattern of its flow of resources. This enables the financial manager to predict at any point in time, the firm's liquidity position and solvency confidence level.

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