



**An-Najah National University
Faculty of Graduate Studies**

**THE IMPACT OF CASH FLOW CLASSIFICATION
ON FINANCIAL RISK ASSESSMENT-A STUDY
APPLIED TO INDUSTRIAL FIRMS LISTED ON
THE STOCK EXCHANGES OF PALESTINE,
AMMAN, AND GULF COOPERATION COUNCIL
COUNTRIES FOR THE PERIOD 2018-2022**

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**This Thesis is submitted in Partial Fulfilment of the Requirements for the Master
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University, Nablus, Palestine.**

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Dedication

الى شهداء فلسطين فلا غابوا عن اذهاننا لحظة ولا يغيبون..

الى اساتذتنا الذين وهبوا لنا عظيما من وقتهم فهم لنا اباء ومعلمين..

الى غاليتي وملكتي الى المرأة العظيمة التي استمد منها قوتي والدتي الحبيبة..

الى من أحمل اسمه بكل افتخار، سيدي وسندي والدي العزيز رائد..

الى رفيق الكفاح في مسيرة الحياة، من كابد ليراني متميزة زوجي فارس..

الى اخوتي وأخواتي فدائما ما أرى في عيونهم أملي وبني يأملون..

الى بسمة حياتي ابنتي ايليا، ونبض القلب ومهجة الفؤاد اولادي براء ورواد..

الى رفيقات العلم التي جمعتني بهن أروقة الجامعة، واخص بالذكر صديقتي مرام مشاقي إحدى المكاسب

الجميلة في الحياة وباسمين عمر رفيقات العلم والعمل.

الى كل قريب وصديق ساندني ودعا لي، أهدي لكم ثمرة نجاحي والحمد لله على ما وهبني..

وشكرا لكل من ترك بصمة في حياتي لكل من لم تسعهم الورقة ووسعهم قلبي..

فهي لحظة طالما انتظرتها وحلمت بها واخيرا عانقت حلمي الجميل..

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قال تعالى: ﴿ رَبِّ أَوْزِعْنِي أَنْ أَشْكُرَ نِعْمَتَكَ الَّتِي أَنْعَمْتَ عَلَيَّ وَعَلَىٰ وَالِدَيَّ وَأَنْ أَعْمَلَ صَالِحًا تَرْضَاهُ

وَأَدْخِلْنِي بِرَحْمَتِكَ فِي عِبَادِكَ الصَّالِحِينَ ﴾ [النمل: 19]

وانطلاقاً من قول رسولنا الكريم: (من لا يشكر الناس لا يشكر الله) فإنني اتقد بالشكر الجزيل لكل من مد يد العون والمساعدة وفي مقدمتهم الدكتور الفاضل غسان دعاس والدكتور الفاضل معز ابو عليا اللذان تشرفت بإشرافهما على هذا البحث حيث كانت لملاحظاتهم القيمة وتوجيهاتهم السديدة ومعاملتهم الكريمة الاثر الكبير في وصول البحث الى هذه الصورة.

كما اتقدم بالشكر لجميع طاقم برنامج ماجستير المحاسبة في جامعة النجاح الوطنية لمجهودهم القيم في تعليمنا واناة عقولنا، وأعضاء لجنة المناقشة المحترمين.

واسأل الله العليّ القدير أن يجزي الجميع عني خير الجزاء، وأن أكون قد وقّفت في إعداد هذه الرسالة بإتقان وإحسان.

Declaration

I, the undersigned, declare that I submitted the thesis entitled:

**THE IMPACT OF CASH FLOW CLASSIFICATION
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APPLIED TO INDUSTRIAL FIRMS LISTED ON
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I declare that the work provided in this thesis, unless otherwise referenced, is the researcher's own work, and has not been submitted elsewhere for any other degree or qualification.

Student's Name

Wala'a Raid Jbara

Signature:

Wala'a Jbara

Date:

25/11/2024

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Abstract

This study sought to identify the impacts of cash flow classification on the risk assessment of industrial firms listed on the Palestine, Amman, Saudi Arabia, Muscat, Kuwait, Qatar, Bahrain, and Dubai stock exchanges. The study sought to achieve several goals, including determining the impact of cash flow classification represented by the main activities (operating, investing and financing) on the assessment of risks (liquidity, solvency and financial flexibility). The study sample consisted of 181 industrial firms from 2018 to 2022. Descriptive and analytical approaches were used, and multiple linear regression was conducted, using the fixed effects method, to achieve the study objectives. The results showed that the classification of operating, financing, and investing cash flows statistically impacts liquidity risks, solvency, and financial flexibility. In light of this, the study recommended maintaining an appropriate liquidity level. The industry index is considered a measure of the firm's liquidity level and a study of the response of cash flows and risks to economic growth, inflation, and interest rates.

Keywords: Cash flows, liquidity risk, solvency risk, financial flexibility risk.

Chapter One

Introduction and Theoretical Background

1.1 Background of the Study

The cash flow statement is one of the primary financial statements that international accounting standards mandate to be prepared alongside the income statement and the statement of financial position. This statement stands out as an analytical tool among various financial analysis tools, as it reflects the nature of the activities of any organisation by revealing its operating, financing and investing reality (Sabir & Hussein, 2023). Financial economics experts generally agree that cash flows, which indicate the firm's financial solvency, assist investors in evaluating the firm's ability to continue as a going concern (Li, Gupta, Bu, & Kannothra, 2023). Evidence of this is found in what the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have approved regarding the preference of international and local public and private firms to apply direct cash flow statements within their financial statements, particularly cash flows from operating activities, which cash receipts from customers and cash payments to suppliers represent (Salem, 2019).

Although classifying cash flow items is challenging (Liang, 2021), classification is essential to financial reporting as it encompasses the cash inflows and outflows from a firm's operating, investing, and financing activities (Abd El Razeq, Hosny, & El Beheri, 2014). Consequently, the IASB issued the IAS 7 "Statement of Cash Flows" in December 1992. Businesses must prepare a statement of cash flows at the end of an accounting period following the IAS 7 Statement of Cash Flows. Operating, investing, and financing activities are the three classifications of cash flows. This classification allows participants to assess the type and timing of cash flows, understand a firm's cash management procedures, and assess its capacity to generate and manage cash flows as well as forecast future cash (Glaser, Mayer, & Milbradt, 2023; Girón, 2022; Özcan, 2020).

The growth of the Palestine, Jordan, and the Gulf Cooperation Council Countries economy depends significantly on the industrial sector, which creates job opportunities, develops technology, diversifies exports, maintains competitiveness in global markets, and meets the population's needs in Palestine, Jordan, and the Gulf Cooperation Council

Countries. The various industrial sector industries, which include manufacturing, mining, construction, and energy, must be evaluated (Abdo & Onour, 2020).

Firms must assess risks to identify potential risks that may affect a particular activity to take the necessary measures to reduce these risks by enhancing performance and quality and using resources effectively and efficiently. Per agency theory, appropriate compensation incentives should be used to match the interests of management with the interests of owners (Li, Gupta, Bu, & Kannothea, 2023; Kostyuchenko, 2021). Accordingly, the cash flow statement is considered one of the main tools firms use to manage risks related to liquidity, financial solvency and financial flexibility by classifying the firm's activities into three main activities: operating, investing and financing (Akumu, 2014).

1.2 Research problem

The financial crises that occurred in recent years, which led to the bankruptcy of many major global firms and organisations, raised a critical issue: the conflict of interest between owners and management according to the contractual relationship. Managers often pursue their interests by manipulating financial statements, including incorrectly classifying items in the cash flow statement. This manipulation, in turn, exposes the firm to numerous risks and undermines investor confidence (Nouri & Salman, 2020). Management reclassifies cash flows from operating to financing activities to conceal underlying issues such as declining sales or profitability and present a more favourable view of a firm's financial position. This reclassification creates a misleading perception of a firm's capacity to generate sustainable operating cash flows (Glaser, Mayer, & Milbradt, 2023).

In 2001, an accounting scandal emerged at Enron, the most innovative firm in the US energy sector. Enron hid debt and inflated profits using complex and misleading accounting techniques and presented a better financial picture than it had by misclassifying cash flows. When the discrepancies were discovered, they caused a disaster. In 2002, a scandal rocked the telecommunications firm WorldCom, which incorrectly classified operating expenses as capital expenditures. The firm increased its operating cash flows and inflated its profitability and financial stability in a fictitious

manner. As a result of this manipulation, the firm declared bankruptcy once the fraud was exposed, and the CEO was convicted of fraud and other crimes (Abdo & Onour, 2020).

The COVID-19 pandemic exposed significant weaknesses in the industrial sector, The Corona crisis has caused significant harm to supply chains as international transportation has come to a halt, resulting in significant losses for suppliers from industrial companies due to their customers either cutting production or completely ceasing production. This put a great deal of pressure on businesses' earnings, cash flows, revenues, and general solvency (Mirza, Rahat, Naqvi, & Rizvi, 2023).

Firms face all types of financial risks, perhaps the most significant of which is the failure to meet their obligations to creditors on the agreed dates, especially following the major financial crises that various firms worldwide have experienced. This concern necessitates that they take appropriate preventive and precautionary measures to manage these risks by focusing on liquidity and financial solvency as effective means to verify their ability to perform the tasks assigned to them efficiently and effectively, as well as their capacity to fulfil their obligations without impacting the firm's capital and assets, ensuring the success, survival, and continuity of a firm's operations (Al Kholi & Al Jondi, 2021).

Liquidity is a vital aspect of a firm's overall management. It refers to the balance between resources in the form of cash or those easily converted into cash (Current Assets) and accrued liabilities (Current Liabilities) (Darweesh, 2022). Financial solvency is attained by enhancing the value of a firm's assets concerning its liabilities to ensure its long-term continuity (Abd-Alfatah, Alshafiei, & Atiya, 2019).

Because the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) share the goal of enabling financial statement users to more accurately predict future cash flows, the impact of flexibility in cash-flow classification and its implications are essential (Gordon, Henry, Jorgensen, & Linthicum, 2017).

IAS 7 allowed flexibility in the classification of interest, tax and dividend so according this standard interest paid and interest and dividends paid are typically classified as operating cash flows for a financial organisation. However, there is no agreement on the classification of these cash flows for other entities; they can be classified as operating

cash flows because they contribute to determining profit or loss. Instead, they can be classified as financing and investing cash flows because they are costs associated with obtaining financial resources or returns on investing. In contrast, taxes paid are typically classified as cash flows from operating activities unless it is practical to identify the tax cash flow as an investing or financing activity, depending on its nature, which will impact financial flexibility risk (IASB, 2023).

The risk management section reports to the board of directors and oversees risk assessment. Creating a risk management division under the direction of the board of directors is possible. The board is responsible for determining the firm's risks, how to manage them, and how big of a risk the organisation takes. The enormous losses brought about by unethical business practices at Enron, Arthur Anderson, and numerous other firms have demonstrated the significance of individuals' roles and leadership positions in an organisation (Abdo & Onour, 2020).

Business failure, bankruptcy, and financial distress are all terms that convey similar meanings when describing the financial issues confronting the firm. Because industrial firms operate in a constantly changing environment, they may face risks that could result in failure or financial difficulties. Therefore, a firm's analysis of its financial statements, particularly the cash flow statement and its trends, will allow it to identify any discrepancies in its operating, investing, and financing activities and take steps to rectify them to prevent the firm from facing financial distress or failure in the future (Makhamer, 2023).

Because the industrial sector contributes a significant percentage to the gross domestic product in Palestine, Jordan, and the Gulf Cooperation Concil Countries, any setback in its performance will seriously harm these countries' economies (Al Qaisi, 2020). Accordingly, the problem of the study focused on examining the impact of cash flow classification (Operating Cash Flow, Investing Cash Flow and Financing Cash Flow) on risk assessment (Liquidity Risk, Solvency Risk and Financial Flexibility Risk) in industrial firms in the Emerging Countries that include the Palestine Stock Exchange (PSE), the Amman Stock Exchange (ASE), the Qatar Stock Exchange (QSE), the Kuwait Stock Exchange (KSE), the Muscat Stock Exchange (MSE), Saudi Stock Exchange (SSE), Bahrain Stock Exchange (BSE) and Dubai Financial Market (DFM).

Based on the above discussion, the following main question address the study's problem:

Q1: How does cash flow classification impact the risk assessment, including liquidity risk, solvency risk, and financial flexibility risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022?

The subsequent sub-questions have been established:

Q1a: How does cash flow classification impact the liquidity risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022?

Q1b: How does cash flow classification impact the solvency risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022?

Q1c: How does cash flow classification impact the financial flexibility risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022?

1.3 Research objectives

This research aims to identify the theoretical aspects underlying the preparation of the cash flow statement and the accurate categorization of items into three main activities: operating, investing, and financing activities, as well as their impact on assessing the potential risks that the firm may encounter to take the necessary measures to overcome them (Saeed & Qaradaxi, 2023). This study aims to enable investors to depend on the cash flow statement for their investing decisions (Özcan, 2020).

For internal and external stakeholders, the cash flow statement is crucial since it clarifies the changes in the cash during a financial period (Suciani & Setyawan, 2022). However, the classification of cash flows has been a debatable issue in the field of risks, so this research focuses on liquidity, solvency and financial flexibility risk for firms. Based on the above, the main research objective is the following:

O1: To investigate the impact of cash flow classification on the risk assessment, including liquidity risk, solvency risk, and financial flexibility risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022.

Based on this, the following sub-objectives can be formulated:

O1a: To investigate the impact of cash flow classification on the liquidity risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022.

O1b: To investigate the impact of cash flow classification on the solvency risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022.

O1c: To investigate the impact of cash flow classification on the financial flexibility risk of industrial firms listed on PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM for 2018-2022.

1.4 Research Significance

Because cash flows significantly impact a firm's long-term success or failure, it is thought that how well a firm classifies its cash flows may reduce its exposure to risks related to liquidity, financial flexibility, and possible financial solvency. So, the study's scientific and practical implications for understanding how cash flow classification affects risk assessment are what makes it so important (Abdo & Onour, 2020).

1.4.1 Scientific Significance

The study's Significant lies in the fact that few previous studies and literature have been published on the impacts of cash flow classification on risk assessment, and they have not directly examined this impact.

1.4.2 Practical Significance

By understanding how to classify cash flows to lower potential risks, industrial firm departments can better meet the objectives of owners, management, employees, and other relevant parties. It is in management's best interest to lower risks because the firm's capacity to continue operations and mitigate potential risks acts as an indicator of management effectiveness and so on for the other groups about industrial enterprises. Investors, analysts, and stakeholders must comprehend how cash flow classification affects risk assessment to make well-informed judgments (Alawneh, 2019), given the critical role played by the industrial sector in contributing added value to the gross domestic product (Al Qaisi, 2020).

Cash flow analysis allows investors and lenders to assess a firm's capacity to generate enough funds to meet its daily expenses and debt obligations, as well as to assess the firm's solvency, ability to invest in growth opportunities, and maintain financial stability. Therefore, the study also derives its importance from the interest in international

accounting standards related to the statement of cash flows and clarifying the impact of cash flow classification on the assessment of potential risks (Darweesh, 2022).

The study's conclusions help shed light on the efficacy of the cash flow classification and offer suggestions for future enhancements or modifications that would be required to increase the transparency and accuracy of risk assessment in the context of industrial firms listed on eight exchanges, including the Palestine Exchange, Amman Exchange, Qatar Exchange, Kuwait Exchange, Muscat Exchange, Saudi Exchange, Bahrain Exchange and Dubai Exchange (Afiezan, Wijaya, Priscilia, & Claudia, 2020).

Therefore, it is crucial to research how cash flow classification affects risk assessment since it has financial analysis and decision-making applications. Research shows how well a firm can create and handle cash, which is necessary to pay bills, invest in expansion, and give shareholders their money back. Precise cash flow classification offers valuable information about the origins and applications of funds, assisting stakeholders in evaluating a firm's liquidity, solvency, overall financial performance, and future financial outlook. Analysts can conduct insightful financial statement analysis, such as ratio analysis, trend analysis, and benchmarking, with the help of accurate classification. This assessment helps measure the firm's profitability, efficiency, and financial stability—all critical factors in risk assessment that include financial flexibility, solvency, and liquidity risks (Abdo & Onour, 2020; Al-Noweran, 2019).

Additionally, through cash flow classification, lenders and creditors can assess a borrower's capacity to produce enough cash flows to meet their debt service obligations. Misclassification may make it difficult to determine a borrower's actual ability to generate cash flow, which could result in inaccurate credit risk assessment. Lenders can assess default risk and establish suitable terms and conditions with the assurance that accurate classification provides (Dika, Sholihin, & Bakti, 2022).

1.5 Theories

Liability Management Theory

Because liability and liquidity management are closely intertwined, the 1960s saw the emergence of this theory, which is still regarded as one of the most significant regarding liquidity management. According to its assumptions, adhering to traditional liquidity

standards, such as keeping liquid investing and assets, is unnecessary. This is because this theory posits that banks and other businesses can borrow money from capital markets to meet their liquidity needs. However, if investors lose faith in an organisation and refuse to roll over such funds, excessive usage of purchased funds in the liabilities structure may cause a liquidity problem (Kyule, 2015).

Agency Theory

According to agency theory, highly leveraged firms typically indicate risks to minimize agency costs and, following signalling theory, communicate to debt holders and investors the firm's capacity to meet short-term obligations. Additionally, because it gives them access to different funding sources, firms listed on foreign stock markets typically disclose risk information further (Elzahar & Hussainey, 2012). Liquidity is seen as a fundamental component in determining bankruptcy risk. Consequently, firms with high liquidity typically disclose more risk-related information to stakeholders to demonstrate that they are doing a great job controlling liquidity risks and maintaining their liquidity position (Mokhtar & Mellett, 2013). Additionally, outside ownership may be more likely to reveal risks to lower agency costs because agency theory predicts that businesses with larger (lesser) insider (outside) ownership are likely to be less transparent and more secretive (Elshandidy, Fraser, & Hussainey, 2013; Mokhtar & Mellett, 2013).

Legitimacy Theory

According to the Legitimacy Theory, a firm will typically disclose information regarding possible risks and challenges to gain influence over shareholders, justify several decisions, keep clear of legal trouble and damage to its firm, and minimise the need for new regulations. Thus, establishing legitimacy to a firm's actions makes it possible to show that it can effectively manage and overcome risks, improve investor confidence, and draw in vital resources (Oliveira, Rodrigues, & Craig, 2011).

Stakeholder Theory

According to the Stakeholder Theory, a firm's management owes it to its stakeholders to comply with their moral obligations, which include providing them with information about risks so they can make decisions and protect their wealth. This approach enhances stakeholder trust and a firm's reputation (Habbash, Hussainey, & Awad, 2016).

Political Cost Theory and Positive Theory

Positive and political cost theories acknowledge that firms are politically sensitive, which could lead to wealth transfers. This theory sought to predict behaviour, including how managers would respond to newly proposed accounting standards and the accounting policies they would select for their organizations. Businesses may have a tendency to disclose risks in order to avoid additional political considerations, lower control costs, and preserve the firm's reputation. Accurately predicting events in the real world is the goal of a "positive" theory (Osho & Ayorinde, 2018).

The Shiftability Theory of Liquidity

The Shiftability Theory of Liquidity was put forth by Moulton (1918), who asserted that there is no need to rely on maturities provided the organisations, particularly the banking sector, hold a significant quantity of assets that may be changed for cash without suffering a large loss in an emergency. Put differently, an asset needs to be instantly transferable without causing capital loss when the demand for liquidity materialises for it to be considered perfectly shiftable (Kyule, 2015).

Signalling Theory

Signalling theory claims that the existence of diversity among members concerning age, Professional experience, education, and gender may serve as an incentive for disclosing risks to improve a firm's performance and reputation (Saggar & Singh , 2017). Reducing opportunistic management practices and promoting risk disclosure transparency are the two advantages of separating the roles of chairman and CEO (Moumen et al., 2016). By disclosing more risk information, an efficient audit committee helps to lower control costs and minimize conflicts between owners and management (Elshandidy, Fraser, & Hussainey, 2013).

Trade-off Theory

Trade-off theory posits that when deciding whether to employ debt financing for a firm, management typically balances the potential risk of financial difficulties against the interest tax shield that comes with using debt financing. When a firm's use of debt financing lowers the likelihood of the firm experiencing financial difficulties and the interest costs related to the debt lower the firm's tax expenses, a firm's cash flow increases

after taxes. However, if the firm uses debt financing, there is a greater chance of financial difficulties, and the benefits from the interest tax shield decrease (Qin, 2024).

Static Trade-off Theory

Per the static trade-off theory, corporate managers are motivated to avoid wasting free cash flow on perquisites and bad investing. Debt financing limits the free cash flow available to managers and helps control agency problems (Martinez, Scherger, & Gue, 2019).

Pecking Order Theory

Pecking Order Theory posits that there does not seem to be a "perfect debt-to-equity ratio." The POT is based on the idea that managers and investors have asymmetric information that influences managers' preferences for raising capital (Abdeljawad, Abu Alia, & Demaidi, 2024). According to the POT, firms prefer to fund investing opportunities and other activities using internally generated money or retained earnings. They will only turn to outside financing when internal funds are insufficient. The main idea behind the POT is that businesses would rank different forms of funding according to how much they cost. Retained earnings will be ranked highest, followed by debt, and outside equity will only be considered a last resort (Agyei, Sun, & Abrokwah, 2020).

Life Cycle Theory

According to life cycle theory, life cycle measures can be used to explain future profitability. Previous studies have shown that changes in present profitability, net operating asset growth, and asset turnover (ATO) can all account for variations in future accounting returns, particularly Return on Net Operating Assets (RNOA₀). Since the firm life cycle stage differs in its ability to explain profitability, the cash flow pattern proxy for the life cycle also offers insight into how RNOA may evolve. Furthermore, the cash flow pattern proxy performs better than alternative life cycle proxies. Furthermore, established enterprises bear a disproportionate impact of ATO adjustments on future RNOA changes. This pattern aligns with the theory that competitive constraints force mature organisations to prioritise cost minimisation and efficiency (Dickinson, 2011).

1.6 Theoretical Framework

The International Accounting Standards Board (IASB) has asserted the importance of the usefulness of the accounting information for users of accounting information in decision making (Abu Alia, Abdeljawad, Silwadi, & Salahat, 2025; Alia, Amarnah, & Abdeljawad, 2023).

Users of financial statements may evaluate an entity's capacity to produce cash and cash equivalents as well as its necessity to spend those cash flows by using information about its cash flows. Users' economic choices include an evaluation of an entity's ability to produce cash and cash equivalents, as well as the timing and dependability of that production (IASB, 2023). When analyzed alongside other financial statements, a cash flow statement provides information that enables users to evaluate changes in an entity's net assets, financial structure (including liquidity and solvency), and ability to affect the timing and amounts of cash flows in response to opportunities and changing conditions (Kostyuchenko, 2021).

Cash is the amount that remains after subtracting cash outflows for each of the firm's earlier periods. The cash inflows for the current period, less the cash withdrawals, are referred to as net cash flows. Measures of accrual income are not the same as cash flows. Cash flow measurements identify cash outflows when paid but not necessarily incurred and cash inflows when received but not necessarily generated. The cash flow statement displays cash flow parameters for the three primary firm activities—financing, investing, and operating. The main cash equivalent of accrued net income is operating cash flows, often known as cash flows from operations. In general, cash flow data helps assess a firm's potential to raise capital, pay dividends, satisfy commitments, and expand (Dahiyatm, Weshah, & Aldahiyat, 2021).

A cash flow statement has become an essential component of financial statements because of its significance to users when making investing decisions. It offers information that aids in evaluating a firm's ability to generate cash and its need to utilise these cash flows. Additionally, it classifies cash flows during the period into those from operating, investing, and financing activities while emphasising the capacity of current profits to forecast the firm's future cash flows and delivering clear, reliable, and relevant

information (Salem, 2019). The cash flow statement's high degree of informativeness greatly improves the calibre of investing choices (Özcan, 2020).

In 1984, the Financial Accounting Standards Board (FASB) issued Accounting Standard 5, which stipulated that “the statement of cash flows should be included in the basic financial statements.” In confirmation, the Financial Accounting Standards Board issued Accounting Standard No. (95) in 1987 entitled “Statement of Cash Flows.” In 1992, the International Accounting Standards Board (IASB) issued International Accounting Standard (IAS 7) entitled “Statement of Cash Flows” (Salem, 2019).

Accounting income measures the economic performance, which does not necessarily coincide with the timing of the cash flow, so the managers should be interested specifically in the differences in collection time (from customers) and payment time (to suppliers) and the conflict between those indicates there is a probability cash flow problem (Buus, 2015). Therefore, relying on the cash flow statement to conduct additional financial analyses enhances the beneficiary’s ability to make a rational decision, as it is prepared on a cash basis and not on an accrual basis like other statements. The cash flow statement reveals the actual liquidity of the economic unit, which assists users of financial statements in assessing the unit's ability to explore available financing alternatives rather than resorting to high-cost financing sources (Al Hasnawi, 2018).

According to the substance over form theory, the economic substance of transactions is more important than their formal legal structure. This substance implies that cash flows must be classified not just by their legal or accounting classification but also by the fundamental economic reality of the transaction. This method concentrates on capturing the economic substance of the transaction to create a more accurate picture of the firm's cash flows (Dika, Sholihin, & Bakti, 2022; Chowdhury & Zaman, 2019; Satryo, Rokhmania, & Diptyana, 2016).

The importance of this statement lies in its capacity to convey information regarding the cash flows in and out of the firm through its activities (operating, investing, and financing) over a specific period. Additionally, classifying this data into cash flows based on activities has a common feature that aids in uncovering the strengths and weaknesses in the firm's ability to meet obligations, secure financing, and distribute profits, whether in the short term or long term (Al Qaisi, 2020).

The literature on construction management takes two perspectives on construction cash flow. According to the first perspective, cash flow is the net amount received or paid out because of receipts and payments made within the same operating period (Buus, 2015). This definition can be represented algebraically as:

$$\text{Cash Flow} = \text{Receipts} - \text{Disbursements} \dots\dots\dots (1)$$

Per this perspective, a positive cash flow indicates a net inflow for a given operating period or year, while a negative cash flow indicates a net loss during the same period (Al Qaisi, 2020). Per the second perspective, cash flow is the real flow of funds into or out of a business (Buus, 2015).

The positive or negative sign of each activity in the cash flow statement can lead to various cash flow patterns. Combining the three cash flow signals will result in eight cash flow patterns, the most notable of which is the (+,+,+) pattern. This pattern indicates that a firm's cash flows are unsustainable and can only be maintained temporarily. The (-,+,-) pattern is considered unusual. It can be observed in firms that do not generate enough cash from their operations while simultaneously financing their activities by selling assets and increasing their debt or issuing shares. In contrast, the (-,-,-) pattern indicates a firm that sells assets to fund its operations and pay off its debts (Kordestani, Biglari, & Bakhtiari, 2011).

An entity shows its cash flows in the manner best suited to its business, and a cash flow statement recorded cash flows from operating, investing, and financing activities that took place during a period. Users can assess how such activities affect the entity's financial situation and the quantity of its cash and cash equivalents by using the information provided by the activity classification. The correlations between those activities can also be assessed using this data (IASB, 2023). Differently classified cash flows may be involved in a single transaction. When a loan's cash payback comprises both principal and interest, for example, the principal part may be categorized as a finance activity and the interest part as an operating activity (Bhandari & Adams, 2017).

Accurate cash flow classification offers useful data that can be used to evaluate an organisation's risk profile. It aids in evaluating the firm's liquidity, cash generation capacity, and dependence on outside funding by stakeholders. A more accurate risk

evaluation can be achieved by considering the economic substance of cash flows instead of only their legal form (Khuong, Anh, & Nguyen, 2022).

The International Financial Reporting Standards (IFRS) provide managers greater latitude in classifying items in the cash flow statement. On the other hand, IFRS gives businesses the freedom to record a more accurate assessment of a firm's financial health and risk profile, made possible by proper cash flow classification. It makes it possible to comprehend the firm's cash flow dynamics better, including if it is making sizable investing, depending too much on financing activities, or producing enough cash from its main operations, interest paid, and interest received as operating cash flows or as financing or investing. Theoretically, the appropriate classification of these items is open to debate (IASB, 2023).

Users can evaluate a reporting entity's potential to produce future net cash inflows by looking at information regarding its cash flows over a given time. It details the reporting entity's cash flow, including information on debt repayment and borrowing, cash dividends and other cash payments to investors, and other elements impacting the entity's solvency or liquidity. Users can better comprehend a reporting entity's operations, analyse its financing and investing activities, determine its liquidity or solvency, and interpret other financial performance data with the aid of cash flow information (Abdo & Onour, 2020).

The most liquid asset, cash, offers business flexibility and liquidity. It signifies the start and finish of the business's working cycle. Investing capital into different assets (like warehouses) that are utilised to generate receivables from credit sales is a part of the firm's operating activities. The operating cycle is over when the collecting procedure occurs (Abdo & Onour, 2020).

A fresh cycle of operations can start by giving the business its money back. Evaluating the firm's cash inflows and outflows, as well as its sources of financing, operating, and investing, is one of the most crucial investigative tasks. This methodology assists in evaluating liquidity, solvency, and financial flexibility. Current assets and current liabilities that we can convert into cash quickly and easily without loss are liquidity. The capacity to meet commitments as they arise is known as solvency (Al Hasnawi, 2018). While net operating cash flow is a stronger indication of profitability, gross operating

cash flow is an improved indicator of a business's capacity to produce cash from its operations (IASB, 2023).

One way to acquire or dispose of non-monetary assets is through investing activities. These activities include purchasing and selling personal protection equipment and investing in stocks, which are supposed to bring in money for a business. Lending money and collecting capital are also included (Laghari, Ahmed, & Garcí'a, 2023).

Contributing, withdrawing, and servicing money to support corporate operations is known as financing activities. It entails taking out loans from bonds and other sources and paying them back. It also covers the owners' withdrawals, contributions, and investing returns (dividends) (Abd-Alfatah, Alshafiei, & Atiya, 2019).

The amount of cash flows from operating activities is a critical indicator of how well an entity's operations have generated enough cash to repay loans, sustain its operational capacity, pay dividends, and make new investing without relying on external financing sources. Information about the specific components of historical operating cash flows and other information helps predict future operating cash flows.

Cash flows from operating activities mainly come from the entity's core revenue-producing activities (IASB, 2023). Operating activities in any firm are regarded as its primary support, as they represent current and future cash flows. These activities reflect the firm's ability to generate cash and cash equivalents, as well as its capacity to meet current and future obligations. The components of direct operating cash flows are utilised to assess and measure the firm's capacity to generate future cash flow (Salem, 2019).

Separate cash flow disclosures from investing activities are essential because they represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities (Al Qaisi, 2020). Also, separate disclosure of cash flows from financing activities is important because it helps predict future cash flow claims by capital providers to the entity (IASB, 2023).

The spread of coronavirus (COVID-19) has impacted every facet of social, political, educational, and economic life. Countries focused on risk management and developed a

set of necessary procedures to prevent the consequences of risks or control them by shifting them to another party or lowering them to a level acceptable to firms. The facility's operating performance and financial situation have declined due to the coronavirus (COVID-19) crisis. The facility's capacity to endure is impacted. Saudi Arabia, still experiencing cash flow difficulty, instructed auditors to consider this when examining the finances following the Corona crisis. The auditor should, therefore, consider whether there are any situations or occurrences that might cast doubt on the matter, such as important details regarding the organisation's capacity to continue as a going concern. Investors do not always view negative cash flow as a negative, such as investing payments are often signs of a firm's growth (SOCPA, 2022).

Any exposure a business or organisation has element(s) that could decrease its earnings or force it into bankruptcy is called "business risk." Many factors might contribute to business risk, such as shifting consumer preferences and demand, prevailing economic conditions, and governmental laws and regulations (Abdullah & Jabal, 2019).

Risk is the possibility of being exposed to unfavourable outcomes from future occurrences (CCTA, 1993). Perry and Hayes (1985) and Healey (1982) described risk as the possibility of experiencing financial gain or loss due to participating in the building process. However, Moavenzadeh & Rossow (1976) defined risk as an exposure to loss. According to Bufaied (1987), risk in the construction context is a variable that might vary during a project and lead to uncertainty about the project's ultimate cost, schedule, and quality (Abdo & Onour, 2020).

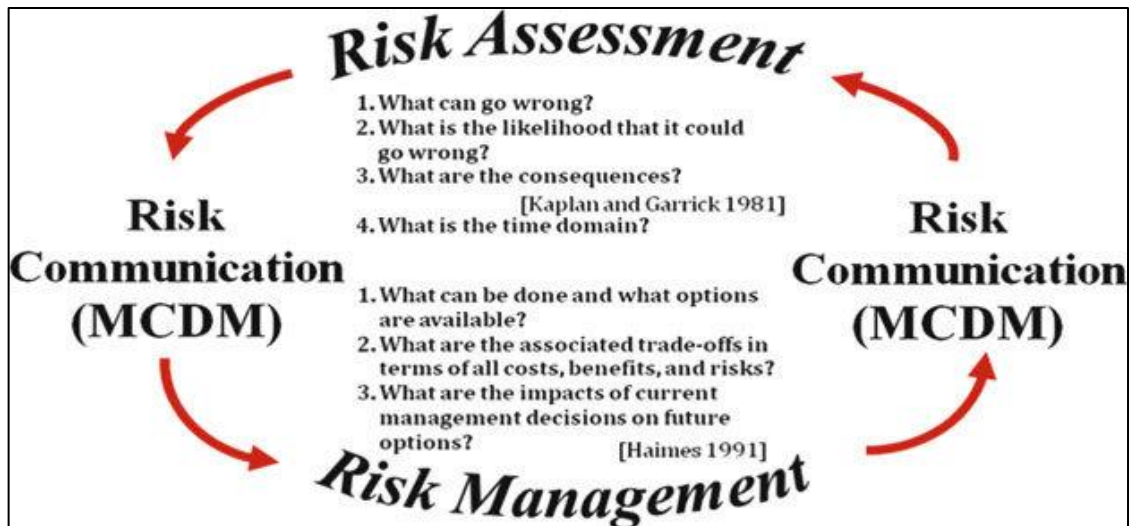
Aven (2016) defines risk as measuring the possibility and consequences of unfavourable events. Although risk management and risk assessment are commonly used interchangeably, it is crucial to remember that some people may refer to both procedures as "risk management." Analysts usually try to answer three main questions regarding risk assessment: What possible dangers exist? How likely is it that those risks will materialise? Furthermore, what ramifications might that have?

By answering these questions, risk analysts can detect, measure, quantify, and evaluate risks and their effects and consequences. Risk management goes beyond the preliminary evaluation of risks conducted by addressing a second set of three critical questions: What actions can be taken, and what alternatives are available? What trade-offs must be

considered regarding all pertinent costs, benefits, and risks? How do current management decisions influence future options?

Figure (1)

Risk Assessment

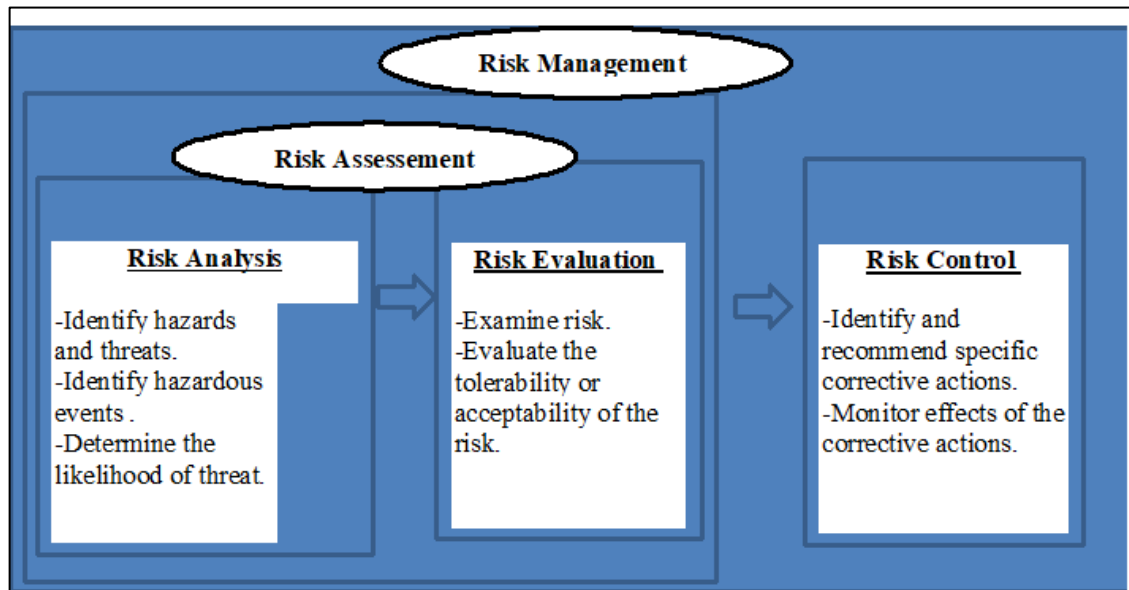


Risk management is determining, quantifying, and assessing a firm's risk today or in the future and implementing the required countermeasures to eliminate or significantly mitigate a risk's negative impacts. Risk management aims to create the best possible policy with defined objectives to trace or minimise anticipated losses (Gennaro, 2021).

The risk assessment process aims to provide decision-makers with an in-depth knowledge of the risks associated with specific natural catastrophes or human activities through a sequence of logical, methodical, and well-defined actions that include identification, measurement, quantification, and evaluation. Some experts distinguish between risk assessment and risk management as two independent things, whereas others include the former in the broader frame of approaches to risk management. When risk analysis and risk evaluation are conducted as an integrated process, the term used is "risk assessment." So, risk assessment is a comprehensive process encompassing risk analysis and evaluation (Aven, 2016).

Figure (2)

Risk Management



A firm's risk management framework should involve an ongoing attempt to evaluate and analyse the business's most likely future risk areas, including how the structure and interrelationships of current risks may change and how the business develops its processes for foreseeing future risks. This involvement entails being aware of the risks associated with the firm's strategic plans, the competitive environment, and the possibility that technological advancements and other areas will influence a firm's profitability and chances for long-term, sustainable value creation. One of the most important aspects of preventing or reducing hazards before they become crises is anticipating future threats. The board or related committees should question the business executives to discuss the most likely sources of material future dangers and risks while considering risk management (Abdo & Onour, 2020).

1.7 Literature Review and Hypothesis Development

1.7.1 Cash flow classification and liquidity risk

Liquidity is defined as the ability to fulfil financial obligations when due in a timely manner, meaning that the essence of liquidity is the availability of cash when needed to ensure safe and sound operations. Financial obligations, such as production and marketing expenses and incoming and outgoing agreements, rarely coincide, so managers

must manage liquidity or prevent cash shortages from disrupting business operations (IAIS, 2021; Buus, 2015).

The relative value of liquidity is 1 time, which is the best while falling below this figure a lot indicates that it is unsafe, and if it is high, it is also not good, and it can indicate idle cash (Salvatore & Tron, 2020).

The rise of this indicator indicates a decrease in liquidity risks, as it reflects an increase in current assets until the firm faces its various obligations (Al-Noweran, 2019). Liquidity risk is the cost of lower profits, which increases the problem of defaulting on obligations due to lower cash inflows and higher corporate consumption (Ghenimi, Chaibi, & Mohamed, 2017).

Highly liquid assets maintained by a corporation should be sufficiently diversified to lower the risk that a significant portion of the portfolio will become illiquid when it must liquidate them to make up for a cash flow shortage. A corporation should evaluate the financial organisation diversity of its highly liquid assets, considering significant contractual groups, contractual mandates, and counterparty instruments in its liquidity risk management report, when applicable. This evaluation needs to be done regarding its asset portfolios and considering the larger market to ensure that the market will support the insurance firm's sales without negatively impacting its capacity to profitably dispose of its highly liquid assets. Businesses might think it necessary to develop, as part of their liquidity risk management, quantitative limits on assets and exposures to assist in achieving these goals (IAIS, 2021).

Liquidity is the strategy to meet both expected and unexpected obligations for money by providing an expected income or reselling assets at fair market value, or by providing another with additional income. Liquidity risk arises when an organisation's needs are not met due to the absence of cash or liquid assets, posing a risk of liquidity. When a significant number of bad debtors are seeking payment, resulting in overspending their available funds, organisations are confronted with this risk (Isran, Hussain, Hafiz, & Salman, 2020).

Liquidity risks can be divided into two types: the first is lack of liquidity, where firms cannot pay their obligations when they are due, and the second type is excessive liquidity.

It is also called a negative shortage, which is the assets left behind if the firm loses full access to short-term financing because of the lack of available funds (Pierret, 2015). Although the first type seems more dangerous to firms, the other type is no less dangerous because it affects the profitability of firms, wastes investing opportunities on them, and threatens their long-term existence in light of a competitive environment within the scope of industrial firms and in the context of technological progress and development (Abdo & Onour, 2020) So, both types must be managed appropriately to ensure the continuity and stability of firms.

In considering the timing of a particular insurer's liquidity requirements, the supervisor may need to evaluate the acceptance of the assets that the insurer views as highly liquid. A supervisor can use the results of the insurer's stress testing to evaluate the amount and quality of the insurer's highly liquid assets to adjust for changes in payment schedules and potential volumes of liquidity requirements. Depending on an insurer's liquidity risk profile, a supervisor may set expectations for the overall quality or liquidity of assets or permit insurers to identify multiple asset portfolios with varying ratios of primary, secondary, and tertiary assets to meet liquidity needs in various stressed horizons. During its evaluation, a supervisor should assess whether these assets are accessible by relevant entities to ensure they can meet their liabilities as they fall due (IAIS, 2021).

Several factors might cause liquidity risks, but the primary ones are changes in the market, the financial crisis, disruptions in operations, unexpected withdrawals of cash, or unplanned outside factors like pandemics, diseases, or wars. Significant difficulties, including insolvency, bankruptcy, harm to one's reputation, and a decline in market share, can be brought on by liquidity issues. Therefore, to avoid future liquidity crises, it is essential to assess liquidity risks and effectively manage cash flow (Dahiyat, Weshah, & Aldahiyat, 2021).

According to Kapadia et al. (2010), a firm's liquidity position is measured and tracked frequently as part of the liquidity risk assessment process. This procedure involves identifying the probable origins and causes of liquidity stress in addition to developing strategies and backup plans to reduce related risks and advance several key goals successfully:

1. Ensuring adequate liquidity: Ensuring that sufficient cash or liquid assets are available to meet current and future financial obligations, such as salaries, debt payments, taxes, dividends, and capital expenditures;
2. Improving cash flow and working capital management by reducing the level of unused cash and enhancing the efficiency of the cash conversion cycle through improving cash forecasting and budgeting;
3. Strengthening liquidity risk oversight by developing clear policies and procedures related to liquidity risk management, including reporting relevant issues and escalating them to senior management and regulators when needed; and
4. Increasing the ability to deal with potential risks: enhance readiness to face liquidity challenges by conducting stress tests and scenario analysis and maintaining a diversified and reliable financing mix and an appropriate cash stock.

Liquidity risk arises because revenues and outlays are not synchronised. The timing of cash in and out-flows is the critical funding liquidity risk driver, and a bank is liquid if it can settle all obligations with immediacy. With a liquidity management strategy, a firm can meet its urgent and short-term cash needs without suffering large losses. It indicates that the business is handling its resources, such as cash on hand, to pay for all obligations, meet all outlays, and preserve its financial stability (Dahiyat, Weshah, & Aldahiyat, 2021).

Liquidity risk assessment is a vital tool that helps organisations identify potential vulnerabilities and implement effective strategies to manage these risks, including maintaining an adequate cash reserve and diversifying revenue sources.

A liquidity management strategy is an organised strategy that minimises the likelihood of significant financial losses while effectively meeting urgent and immediate financial requirements. This strategy indicates that a firm effectively allocates its resources, especially its cash reserves, to settle debt, pay costs, and maintain a steady cash flow. For firms with high debt levels, a comprehensive liquidity management strategy should include actions to close the cash flow gap between current loan obligations and available cash. Liquidity management is a set of continuous strategies and practices meant to guarantee that your business can always obtain funds on time. This ability must be present

to pay salaries, purchase goods and services, and embrace current investing opportunities (Koh, 2023).

Ugo and Egbuhuzor (2022) studied the impact of cash flow management on measured liquidity at the current rate using the pharmaceutical firms listed on the Nigerian Stock Exchange for 2011-2020. Using multiple regression analysis and Pairwise Granger through the EViews program, the researchers found a non-statistically significant positive effect of investing activities on liquidity; the reason for this is that the management of the studied firms did not implement sound strategies to support liquidity adequately. However, financing activities had a statistically significant negative impact on liquidity; this is because financing activities enhanced the performance of their financial resources represented by liquidity, in addition to finding a non-statistically significant positive impact of operational activities on liquidity (Isran, Hussain, Hafiz, & Salman, 2020).

Financial and wellness crises are sudden systemic events associated with systemic risks and liquidity in financial markets. These occurrences have the potential to increase the liquidity in these markets. Higher fluctuations in price may raise market risks and damage their stability. Given price volatility, it could be challenging for investors to evaluate assets fairly and make wise investing choices. Accordingly, a lack of liquidity and significant price volatility can raise investing risks and make investors less inclined to invest in financial markets. When investors sell their assets in financial markets during a crisis, it typically has an adverse impact that builds up and improves market volatility (Mirza, Rahat, Naqvi, & Rizvi, 2023).

Liquidity risk can be eliminated when a firm can quickly turn its assets into cash to fulfil its short-term demands (Chowdhury & Zaman, 2019). A healthy and positive operating cash flow indicates liquidity strength, indicating that a firm's operations generate enough cash to meet its short-term obligations (Abdo & Onour, 2020). Negative investing cash flows can refer to capital expenditures or large investing, which can affect liquidity in the short term. Conversely, positive investing cash flows may enhance liquidity by providing additional cash reserves or liquid assets. Cash flows of positive financing can contribute to liquidity if they include capital injections, debt proceeds or other external sources of financing. On the contrary, cash flows of passive financing resulting from large debt or dividend payments may reduce liquidity (Esin, 2015).

A sufficient cash reserve is necessary to maintain financial stability and avoid liquidity crises, which means setting up money for unforeseen costs or emergencies in business emergencies. A corporation with a cash reserve can handle unforeseen circumstances like falling sales, late payments, or increased expenses without taking out loans or liquidating assets. Additionally, a cash reserve can act as a cushion against changes in interest rates and the market. A firm's required cash reserve is determined by several criteria, including its size, growth rate, industry, and risk tolerance (Dahiyat, Weshah, & Aldahiyat, 2021).

An entity must include information regarding its supplier finance agreements so that financial statement users can evaluate how those agreements affect an organisation's cash flows, obligations, and exposure to liquidity risk (IASB, 2023).

The financial analysis of cash flows assists in assessing the firm's financial condition in detail, determining a firm's level of financial liquidity, assessing the success or failure of the financial plans that have been established, identifying any weaknesses in those strategies and taking steps to correct them, researching potential investing opportunities, and supplying the capital required to take advantage of them. Financial analysis of cash flows also plays a part in managing the flow volume and financing provided by the business and efforts to offer more affordable options. It is evident how vital financial analysis of cash flows is, particularly when making significant investing decisions or preparing to take on new market risk (Dahiyat, Weshah, & Aldahiyat, 2021).

Ratios are also used to assess a firm's capacity to fulfil short-term obligations (current liabilities) using its cash and other assets (current assets) that can be converted into cash within a relatively short timeframe. In this study, the researcher used the current ratio, which is the ratio of current assets to current liabilities. It is one of the oldest and most used ratios, with a typical current ratio of 2:1 (Ramadan & Fahmi, 2020). The operating cash flow ratio calculates how successfully a business can use the cash flow from its main operations to settle its current debts. This financial indicator displays the amount of money a business makes from operations for every dollar of current liabilities. Because management can manipulate earnings, which involve accruals, the operating cash flow ratio is regarded as a particularly useful indicator of a firm's short-term liquidity (CFI, 2024).

Based on the above, the following main hypothesis was formulated:

H1: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of cash flow classification on liquidity risk assessment.

The following sub-hypotheses were derived from it:

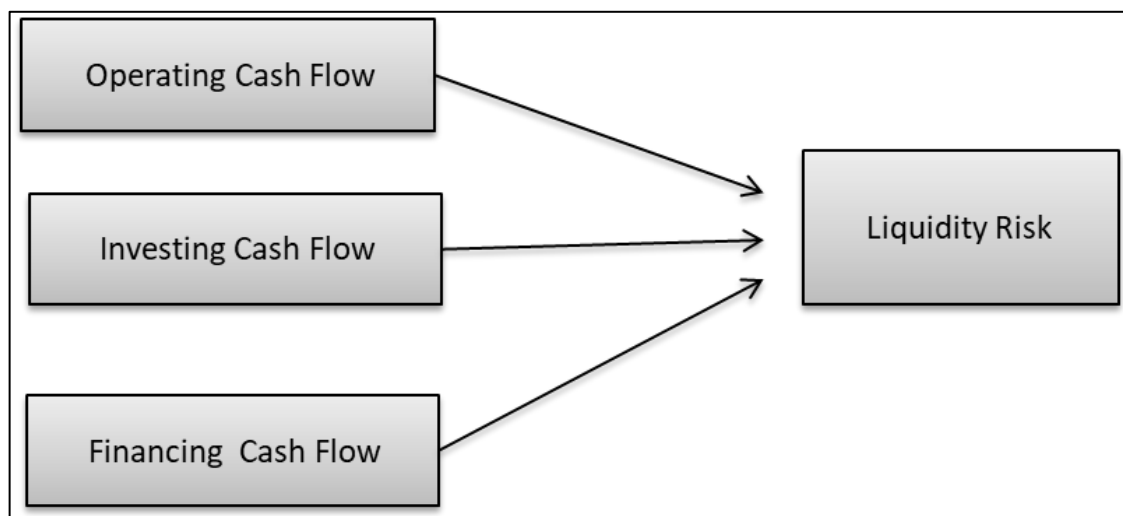
H1a: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of operating cash flow on liquidity risk assessment.

H1b: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of investing cash flow on liquidity risk assessment.

H1c: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of financing cash flow on liquidity risk assessment.

Figure (3)

Cash flow classification and liquidity risk



1.7.2 Cash flow classification and solvency risk

The ability of an organisation to meet its financial responsibilities is referred to as solvency. This assessment considers a firm's capacity to fulfil its obligations, which include repaying the principal amount of the loan and interest. Solvency ratios provide essential information about how much debt a firm has concerning its capital structure and whether its earnings and cash flows are sufficient to pay interest and other fixed charges when they come due. When a firm's current assets equal or exceed its total liabilities, it is

said to be solvent; when total assets drop below current liabilities, the firm becomes insolvent (Abdul Rahman, 2017).

Corporate insolvency occurs when a firm cannot pay its debts or meet its financial obligations. It is a big problem that can significantly affect the firm, its stakeholders, and the broader economy. Insolvency can lead to bankruptcy of enterprises through financial mismanagement, excessive debt burden, low revenues, economic downturn, and operational inefficiency (Isran, Hussain, Hafiz, & Salman, 2020).

Financial solvency is an issue that various theories address, the most well-known of which is the financial solvency management theory, created in 1984 by researchers Myers and Majluf. The theory's findings indicate a negative correlation between solvency and financial performance. According to hierarchy theory, asymmetric information increases financing expenses in corporate finance. Firms place considerable importance on their funding sources and initially prefer to utilise internal financing when available. There are three main types of financing: internal funds, debt, and new equity. Debt is then used as their last option, and acquiring equity is their last possible choice. This choice results from the need for new stock to be issued, which entails the introduction of external ownership in the firm. Therefore, the type of debt a firm chooses can indicate its need for external financing (Dahiyat, Weshah, & Aldahiyat, 2021).

Several steps must be followed to build a framework for evaluating solvency called the management umbrella or enterprise risk management, which requires discussing the evaluation of assets and liabilities, risk margins for uncertainty in assets and liabilities, measures of fluctuations in assets and liabilities, and modelling by defining risk categories, mitigation and diversification, and the firm and its supervisor must evaluate the continuity of the firm and the horizon its future timeline (Abd El Razek, Hosny, & El Beheri, 2014).

When a firm's bad financial situation prevents it from meeting its obligations, it should manage its solvency risk by taking practical action. Solvency risk refers to the possibility that an organisation cannot fulfil its obligations. Solvency risk is more apparent when a business is unprofitable or manages its assets poorly (Isran, Hussain, Hafiz, & Salman, 2020).

A consistently negative or low operating cash flow may indicate that the firm is not generating enough cash to cover its daily expenses and fulfil its financial obligations, which increases the risk of insolvency. If the cash flows from investing activities are negative, this indicates investments that do not bring sufficient returns and that a firm constantly uses cash for investing without generating positive cash flows in return; it may strain its liquidity and increase the risk of insolvency, negative cash flows from financing activities indicate a heavy debt burden that can increase the risk of insolvency if the firm is unable to fulfil its obligations (Wei, Ding, & Xu , 2017).

Harjanti, Farhan, & Radiany (2019) stated that a firm can be valued by its solvency when it has sufficient assets to pay all its debts, or conversely, it can be said that the asset ratio is better than the debt ratio. So, the debt-to-total asset ratio indicates that if an asset owned by the firm is insufficient to pay the debts, the firm is insolvent.

Also, the debt-to-equity ratio explains how much capital a firm provides as a guarantee against its debts. A higher ratio is better because a low ratio requires the firm to seek additional funding from the owner (Lumbantobing, Sulivyo, Sukmayuda, & Riski, 2020).

Based on the above, the following main hypothesis was formulated:

H2: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of cash flow classification on solvency risk assessment.

The following sub-hypotheses are derived from it:

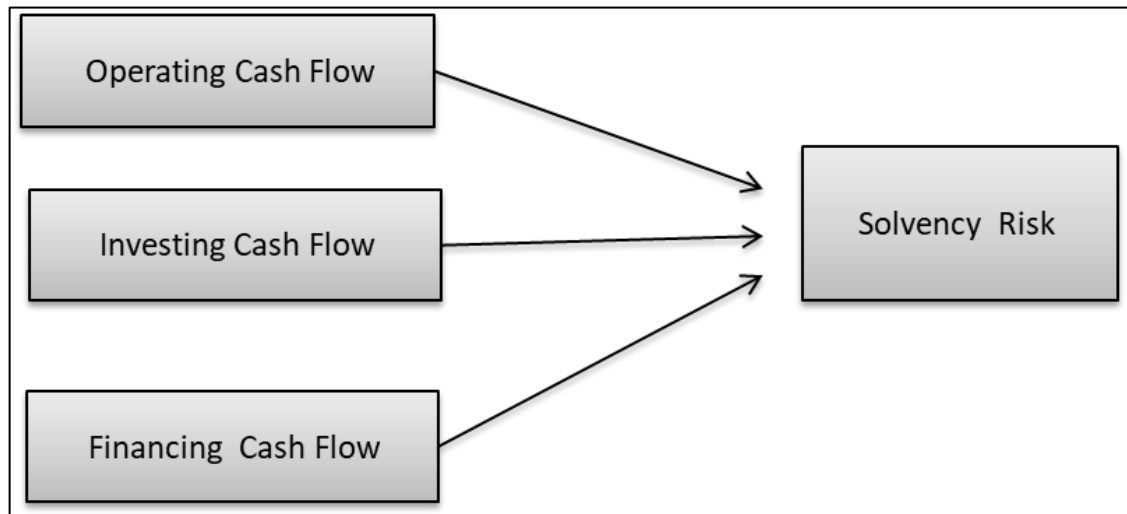
H2a: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of operating cash flow on solvency risk assessment.

H2b: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of investing cash flow on solvency risk assessment.

H2c: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of financing cash flow on solvency risk assessment.

Figure (4)

Cash flow classification and solvency risk



1.7.3 Cash flow classification and financial flexibility risk

Financial flexibility indicates the firm's ability to maintain liquidity and supply cash against unexpected violations that occur during operating activities. Firm with financial flexibility prefer following a rational policy to manage the debts related to their financial policies, which will eliminate excess required and expected cash payments over expected cash resources (Gordon, Henry, Jorgensen, & Linthicum, 2017). Thus, the more financially flexible a firm is, the more it can recover relatively quickly. IFRS allows the manager to be flexible in classifying the paid interest and dividends under operating, investing and financing activities in cash flow statements (Tascón, Mejía, & Sánchez, 2021).

Debt capacity, or financial flexibility, is a crucial safety net against cash shortages and investing reductions. Compared to firms with less financial flexibility, dividend payers with more financial flexibility have fewer investing cuts for a given shortfall. It appears that asset sales, cash balance reductions, and new equity offerings offer limited flexibility; the lack of a comparable buffer from equity lends credence to models of expensive external equity financing (Liang, 2021). Although cash flows associated with asset acquisitions are usually classified as cash flows from investing activities, cash payments for manufacturing or purchasing PPE held for rental to others and then held for sale (as inventory) in the regular course of business are classified as cash flows from operating

activities. Later sales of these assets and their rental income are also included in cash flows from operational activities (Gordon, Henry, Jorgensen, & Linthicum, 2017).

Managers have flexibility in classifying interest paid, interest paid, and dividends paid under operating, investing, or financing activities in the cash flow statement according to the International Financial Reporting Standards (IFRS). However, in accordance with U.S. Generally Accepted Accounting Principles (GAAP), these items must be categorized as operating cash flows (OCF) (Gordon, Henry, Jorgensen, & Linthicum, 2017).

Wei, Ding, & Xu (2017) examined the factors that influence cash holdings and made the case that firms with higher external financing costs and significant cash flow variability tend to accumulate and hold larger cash balances. The selling of assets is an additional possible source of financial flexibility. Selling assets might help a firm with a cash shortage avoid reducing investing and dividends. However, this approach may become unaffordable due to asset illiquidity.

Profitability will be linked to classification decisions that increase OCF. On the one hand, firms with lower profitability may be more inclined to choose OCF-increasing classifications, manipulating OCF upward to offset weakness in reported earnings. However, more lucrative businesses may classify their assets in a way that improves OCF to better align their cash flow with their income (Tascón, Mejía, & Sánchez, 2021; Gordon, Henry, Jorgensen, & Linthicum, 2017).

Finally, a firm may maintain financial flexibility by implementing various classification changes that impact reported operating cash flow differently. Firms that increase OCF by making the classification change maximise OCF by excluding interest paid from operating while including interest received and dividends received in operating (Abdo & Onour, 2020).

The international accounting standard states that cash flows for interest paid, dividend paid and tax paid should be disclosed independently, and each should be classified consistently over a period of time (Al Hasnawi, 2018).

The current study measured financial flexibility according to Gordon et al. (2017), as the following:

Interest paid = zero if a firm classifies interest paid in financing cash flow as of the last year reported and one otherwise.

Dividend paid = zero if a firm classifies dividend paid in financing cash flows as of the last year reported and one otherwise.

Tax paid = zero if a firm classifies tax paid in operating cash flows as of the last year reported and one otherwise if it is not practical to determine its nature.

Based on the above, the following main hypothesis was formulated:

H3: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of cash flow classification on financial flexibility risk assessment.

The following sub-hypotheses are derived from it:

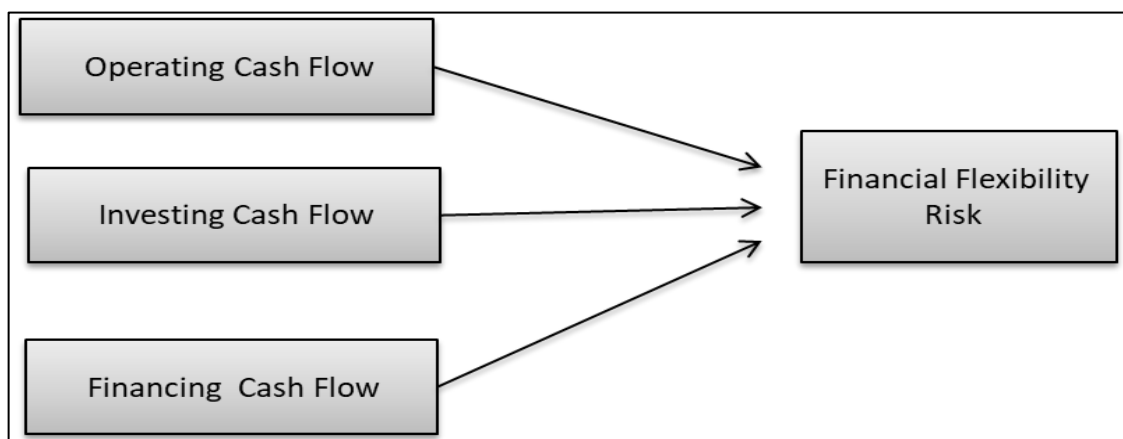
H3a: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of operating cash flow on financial flexibility risk assessment.

H3b: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of investing cash flow on financial flexibility risk assessment.

H3c: There is no statistical impact at a significance level of ($\alpha \leq 0.05$) of financing cash flow on financial flexibility risk assessment.

Figure (5)

Cash flow classification and financial flexibility risk



1.8 The relationship between control variables and risk valuation

Liquidity risk is the inability of firms to pay their short-term loans because of less developed cash flows and more limited access to outside finance. Solvency risk is associated with a firm's capacity to settle its long-term debt; firms are particularly susceptible to solvency risk since they often have lower cash and asset reserves, making it more challenging to generate enough revenue to pay off debt. At the same time, financial flexibility risk is the inability of firms to respond and adjust to changes in their operational environment (Laghari, Ahmed, & Garcí'a, 2023; Yegon, Mouni, & Wanjau, 2014).

Firm size is determined by the number of assets a firm has compared to other businesses in the same industry. The speed and scope of growth are best for a particular firm. Larger businesses may create things at a lower cost than smaller businesses. This difference results from the former's increased learning, expertise, and ability to spread their fixed expenses over a higher volume of output (Kyule, 2015).

Large firms may be more exposed to risk because of their operations' greater complexity and diversity. These businesses typically comply with stakeholder demands for risk disclosure to lower agency costs and information asymmetry (Tauringana & Chithambo, 2016). Because internal control and risk management systems positively affect stock prices and lessen the uncertainty related to future cash flows, highly profitable firms can afford to invest in these systems and enhance their reputations (Khlif & Hussainey, 2016).

In terms of size, the Pecking order theory indicates that somewhat bigger firms are less dependent on outside funding since they can accumulate internally generated funds. As a result, the POT suggests that debt and size are negatively correlated. Furthermore, the "information asymmetry" problem small firms suffer is exacerbated because a large portion of the information they provide banks on loan application forms cannot be easily verified (Agyei, Sun, & Abrokwah, 2020).

Chapter Two

Methodology and Procedures

2.1 Introduction

This chapter includes an explanation of the methods and procedures used by the researcher and details about the study population and sample. It also describes the study variables and concludes with the statistical methods used to analyze the data and derive the results and recommendations.

2.2 Methodology

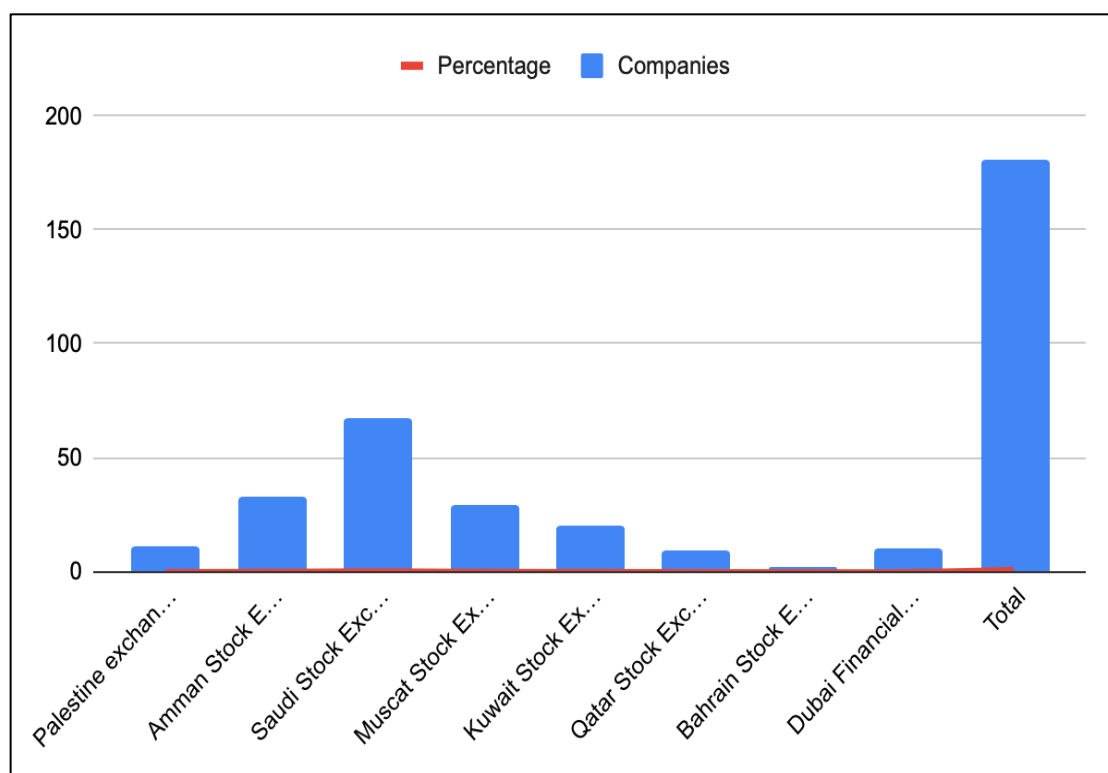
Based on the nature of the study and the information needed to identify the impact of cash flow classification on the assessment of liquidity risk, solvency, and financial flexibility in industrial firms listed on eight stock exchanges, including the PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM but Abu Dhabi Stock Exchange was excluded due to difficulty in accessing data. The researcher employed a descriptive approach due to its appropriateness for the study's objectives. Two sources were utilized to gather information: a primary source consisting of data extracted from the financial statements of industrial firms listed on eight stock exchanges, for the period from 2018 to 2022, and a secondary source involving a review of the literature and previous studies related to the study's topic. The analytical approach was employed to analyze this data using the STATA program because of its appropriateness for the nature of the data.

2.3 Population and Sample of the Study

The study population comprised all industrial sector firms listed on eight stock exchanges: the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, which number 195 firms. The sample included industrial firms listed on the eight stock exchanges mentioned above, with 181 firms representing 92.8% of the study population, and fourteen firms were excluded due to insufficient data. The sample was deliberately chosen because the industrial sector produces tangible and real products, not service products. See Table (1) and Figure (6).

Table (1)*Study Sample*

Name of the Exchange	Population	Frequency	Percentage
PEX	11	11	6.08%
ASE	33	33	18.23%
SSE	76	67	37.02%
MSM	30	29	16.02%
KSE	22	20	11.05%
QSE	11	9	4.97%
BHB	3	2	1.1%
DFM	10	10	5.52%
Total	195	181	100.00%

Figure (6)*Study's sample*

2.4 Variables

2.4.1 Independent Variables

2.4.1.1 Operating cash flows

The classification of operating cash flows sheds light on an organisation's main business operations. Positive operating cash flows show that the business's operations bring in enough money to pay for regular expenses, reinvest in the firm, and maybe pay dividends to shareholders. A persistently negative operating cash flow could indicate troubled finances and a higher chance of insolvency (Kordestani, Biglari, & Bakhtiari, 2011).

Operating cash flow refers to the amount of cash being utilised or received by a business's core operations during a particular period. The data reveals cash inflows and outflows related to the business's regular operations, including changes in working capital, operating expenses, sales revenue, and more. OCF is an important indicator since it shows how well a business can make money from its primary activities (Ranjbar, Ansari, Roohollah, & Hosseini, 2021).

An organisation's operations are generally seen favourably when they generate more cash than they consume, as demonstrated by a positive operating cash flow OCF. This flow suggests that the business has enough cash on hand to pay dividends, invest in expansion prospects, cover operating costs, and settle debt. On the other hand, a negative operating cash flow OCF indicates that the business is not making enough money from its operations and would have to rely on outside funding or other sources to pay its debts (Munter, 2023).

According to the notion of the firm's life cycle, firms implement cash flow management strategies to increase or decrease operating cash flows at the introduction, growth, and decline stages of the life cycle (Mulchandani, Mulchandani, & Jain, 2023). Earnings during the maturity period are more appropriate for the firm since profits increase when the firm's current operating activities succeed. Additionally, businesses have a stable place in the market at this point (Khuong, Anh, & Nguyen, 2022).

Solvency, financial flexibility, and liquidity risks are intimately related to operating cash flow. Positive operating cash flow generally lowers liquidity risk because it guarantees the business has enough cash to pay short-term obligations. Moreover, it reduces financial

flexibility risk by supplying resources for expansion and adaptation in the future. Lastly, good operating cash flow demonstrates a firm's ability to pay off long-term debt, which reduces solvency risk (Alawneh, 2019).

2.4.1.2 Financing cash flows

These are cash flows related to acquiring or returning resources from the owners, obtaining financing from lenders, or repaying loans to them. Financing activities are intended to change the size and components of the organisation's property rights and borrowings. Cash flows from financing activities indicate the degree of availability or utilisation. Cash through stocks, bonds, and loans is the extent to which the firm distributes profits to shareholders (Houaria, Amine, & Walid, 2022).

How financing cash flows are classified provides insight into the organization's capital structure and fund-raising capabilities. A corporation that generates positive financing cash flows raises money from outside sources via bond issuance, stock offerings, and loan applications. On the other hand, an overreliance on debt funding could raise the firm's financial risk (Buus, 2015). Businesses must maintain adequate funding to manage credit uncertainty to reduce credit risk (Isran, Hussain, Hafiz, & Salman, 2020).

Solvency, financial flexibility, and liquidity risks are intimately related to financing cash flow. Inadequate cash flow from funding makes it more likely that a firm would experience liquidity issues, make it harder for the firm to adjust to changing conditions, and cast doubt on its long-term viability. On the other hand, a firm's financial stability and growth can be supported, and these risks can be reduced with enough and steady financing cash flow (Pierret, 2015).

2.4.1.3 Investing cash flows

Investing flows appear to be the most appropriate for accurately classifying the most profitable organisations over the medium to long term. Cash creation from distinctive activities helps address questions regarding firm profitability over shorter time horizons (Salvatore & Tron, 2020).

The firm's capital expenditure and investing activities are made clear by how its investing cash flows are classified. Positive cash flows from investing show that the business actively puts money into long-term assets and possible expansion prospects. However,

significantly negative investing cash flows can lead to overspending on acquisitions, raising a business's risk profile (Ugo & Egbuhuzor, 2022).

A large negative investing cash flow for the firm could mean that a large portion of its funds are invested in long-term projects, which could limit its liquidity. This investing could raise liquidity risk if the business has unforeseen cash requirements or has trouble obtaining short-term funding. It might be less able to alter direction if a sizable amount of its cash flow is allocated to long-term assets or initiatives (Pierret, 2015). However, wise investing that strengthens a business's position in the market or yields profits can also make it more flexible by supplying extra capital or sources of income. It might need to take on debt or outside funding to pay for its investing if it continuously produces a negative investing cash flow. Over-reliance on debt may threaten the firm's stability by raising financial risk and leverage. Positive investing cash flow, on the other hand, especially from successful ventures, can bolster an organisation's asset base and solvency position (Abdo & Onour, 2020).

As per the firm life cycle theory, mature firms have fewer investing options at the mature stage. Rather than seeking out projects that are assured to yield profits, managers concentrate on enhancing the efficacy and efficiency of the operational process (Buus, 2015).

Previous literature claims that when a corporation engages in innovative projects, its dependency grows. This conclusion supports the idea that organisational actions can reduce uncertainty and lead to acquiring a gradually constant supply market. In order to effectively use their resources, a firm must be able to control risk and uncertainty. Businesses should create a suitable framework for managing risks when they embark on creative projects when there is a possibility of risk and uncertainty; otherwise, innovative projects and aims may ultimately suffer (Isran, Hussain, Hafiz, & Salman, 2020).

2.4.2 Dependent Variables

Three variables are considered in this study (liquidity risk, solvency risk and financial flexibility risk).

2.4.2.1 Liquidity Risk

Liquidity is the availability of cash within a firm to manage working capital (current assets and current liabilities) in such a way that avoids large idle cash surpluses or a deficit in the cash required to meet current liabilities. It encompasses all a firm's short-term activities, so the firm must enhance its liquidity planning and consider all incoming and outgoing funds from various sources and for all purposes while maintaining a balance between them and considering the timing of their occurrence. Liquidity must also be managed without adversely impacting the firm's overall objectives, such as profitability and sustainability. Good management of a firm's liquidity means providing funds at an appropriate cost to meet obligations when they are due, maintaining a firm's continuity, and eliminating the risks of financial distress (Ramadan & Fahmi, 2020).

The capacity to convert an asset into cash at any time and not suffer a loss is known as liquidity. The firm suffers a loss when its cash flow prevents it from meeting its obligations on time (Abdullah & Jabal, 2019).

Liquidity risk occurs when selling an asset or security in the market is difficult without changing its price significantly. Liquidity risk occurs when the depth of the market or trading volume for the asset is insufficient, making it difficult to convert the asset into cash quickly and fairly. Because it may affect their ability to meet short-term financing needs, liquidity risk is a critical factor that investors and financial organisations must consider (Chowdhury & Zaman, 2019).

Esin (2015) said that many ratios are used to measure liquidity risk, including the current ratio and operating cash flow ratio.

The current ratio shows how well a corporation can use its short-term assets to pay its short-term debt. It focuses on the business's cash situation and capacity to meet short-term financial obligations. In general, a higher current ratio means a stronger liquidity position and the ability of the business to settle its short-term loans and used money in running a firm is held in a government's securities, savings, cash or other funds. In

contrast, a low ratio means the firm cannot meet its obligations on time (Rochim & Ghoniyah, 2017).

$$\text{Current ratio} = \text{Total current assets} / \text{Total current liabilities} \dots\dots\dots (2)$$

The OCF ratio is among the most crucial financial statements for determining a firm's financial situation and its function in supplying information not included in the income statement. The balance in the cash flow statement is crucial when making financial decisions. It displays the cash impact of all of a business's financing, investing, and operating activities, which aids in highlighting the firm's performance's strong and weak points. It also offers information that can be trusted to assess the firm's liquidity and continuity because its analysis identifies liquidity risks (Abdullah & Jabal, 2019).

A firm's ability to use cash from its core activities to settle its current liabilities is assessed by the operating cash flow ratio. Since this ratio only includes cash from core business operations and not from all other sources of income, it is regarded as a trustworthy predictor of short-term liquidity. Short-term cash flow issues are indicated by a ratio less than one. However, since it shows cash flow enough to cover short-term financial obligations, a ratio larger than one denotes a sound financial situation (CFI, 2024).

Interested parties can compute different cash flow ratios that support risk assessment by examining cash flow classifications. The OCF ratio, calculated by dividing operating cash flow by total debt, is one tool used to assess a firm's capacity to pay down debt. It is an indicator of liquidity risk. The operating cash flow ratio evaluates whether a business can produce enough cash flow from its main activities to meet its immediate financial obligations. It is computed by dividing OCF by the current liabilities of a business (Buus, 2015).

$$\text{OCF Ratio} = \text{Cash Flow from Operations} / \text{Current Liabilities} \dots\dots\dots (3)$$

2.4.2.2 Solvency Risks

The possibility that a business or organisation unable to repay its debts and meet its long-term financial obligations is known as solvency risk. It measures an organisation's capacity to meet its financial obligations and stability. In other words, solvency reflects the firm's ability to repay long-term obligations, including principal payments and

benefits. Since it predicts the possibility of default or bankruptcy, solvency risk is crucial for creditors, investors, and other stakeholders to consider (Gennaro, 2021; Abdul Rahman, 2017).

Many ratios measure solvency risks (Satryo, Rokhmania, & Diptyana, 2016). Among them are the debt-to-equity ratio and the debt-to-assets ratio.

A financial ratio called the debt-to-equity ratio calculates the percentage of a firm's total debt to its shareholders' equity (net assets). It measures the firm's risk of solvency and its capacity to fulfil long-term financial commitments (Wei, Ding, & Xu, 2017). Rising this ratio up to one refers to weak financial solvency and loss of control by the firm (Abdul Rahman, 2017).

An organisation's financial risk may rise if it has a high debt-to-equity ratio, which suggests that the firm depends mainly on borrowed money to support its operations. Conversely, a low debt-to-equity ratio denotes a more conservative capital structure, showing that the firm has less debt than equity (Buus, 2015).

$$\text{Debt-to-Equity Ratio} = \text{total debt}/\text{total equity} \dots\dots\dots (4)$$

The debt-to-assets ratio is the percentage of a firm's assets that are loaned money. It measures the percentage of total debts used in the capital structure (Abdul Rahman, 2017). It offers information on a firm's degree of financial leverage or indebtedness and aids in determining its capacity to pay its debts. A higher debt-to-asset ratio suggests that debt is used to fund a larger share of the firm's assets, which may indicate a higher level of financial risk (Ugo & Egbuhuzor, 2022).

The debt-to-asset ratio is a standard metric that lenders and investors use to assess a firm's trustworthiness and stability. A smaller ratio denotes a more cautious capital structure and a better financial position; a greater ratio can indicate a higher risk of insolvency or difficulties meeting debt obligations (Abd El Razeq, Hosny, & El Beheri, 2014).

$$\text{Debt-to-Assets Ratio} = \text{total debt}/\text{total assets} \dots\dots\dots (5)$$

2.4.2.3 The financial flexibility risks

The current international and U.S. cash flow reporting advice is a set of standardized, adaptable classification rules. Standard setters occasionally need activities to be classified to provide uniformity in classification. In other cases, standard setters either (a) explicitly give the option to choose between different classification categories or (b) mandate that preparers use the predominance principle to classify activities for which there is no explicit guidance. These options allow managers to use their judgment when classifying activities. These situations lead to classification flexibility (Liang, 2021).

OCF projection is based on previous OCF and accruals since they also influence how enterprises are classified. The outcomes for businesses using different classification schemes are not appreciably different (Tascón, Mejía, & Sánchez, 2021; Al-Noweran, 2019). Gordon, Henry, Jorgensen, & Linthicum (2017) concluded that the market's assessment of the permanence of operating cash flows and accruals varies depending on the firm's categorization decisions, and that the results of certain OCF prediction models are sensitive to classification choices.

A set of uniform, flexible classification standards currently serves as the basis for U.S. and international cash flow reporting guidelines. Occasionally, standard setters require activities to be classified to maintain classification uniformity. In other situations, standard setters either require preparers to classify activities without specific guidance using the predominance principle or expressly allow them to pick between several classification groups. This gives managers the flexibility to classify tasks according to their own judgment. Flexibility in classification results from these circumstances (Liang, 2021).

Many ratios are used to measure the risks of financial flexibility (IASB, 2023; Gordon et al., 2017); two of them are:

Interest paid = zero if a firm classifies interest paid in financing cash flow as of the last year reported and one otherwise

Dividend paid = zero if a firm classifies dividend paid in financing cash flows as of the last year reported and one otherwise.

Tax = zero if a firm classifies tax paid in operating cash flows as of the last year reported and one otherwise if it is not practical to determine its nature.

2.5.3 Control Variable

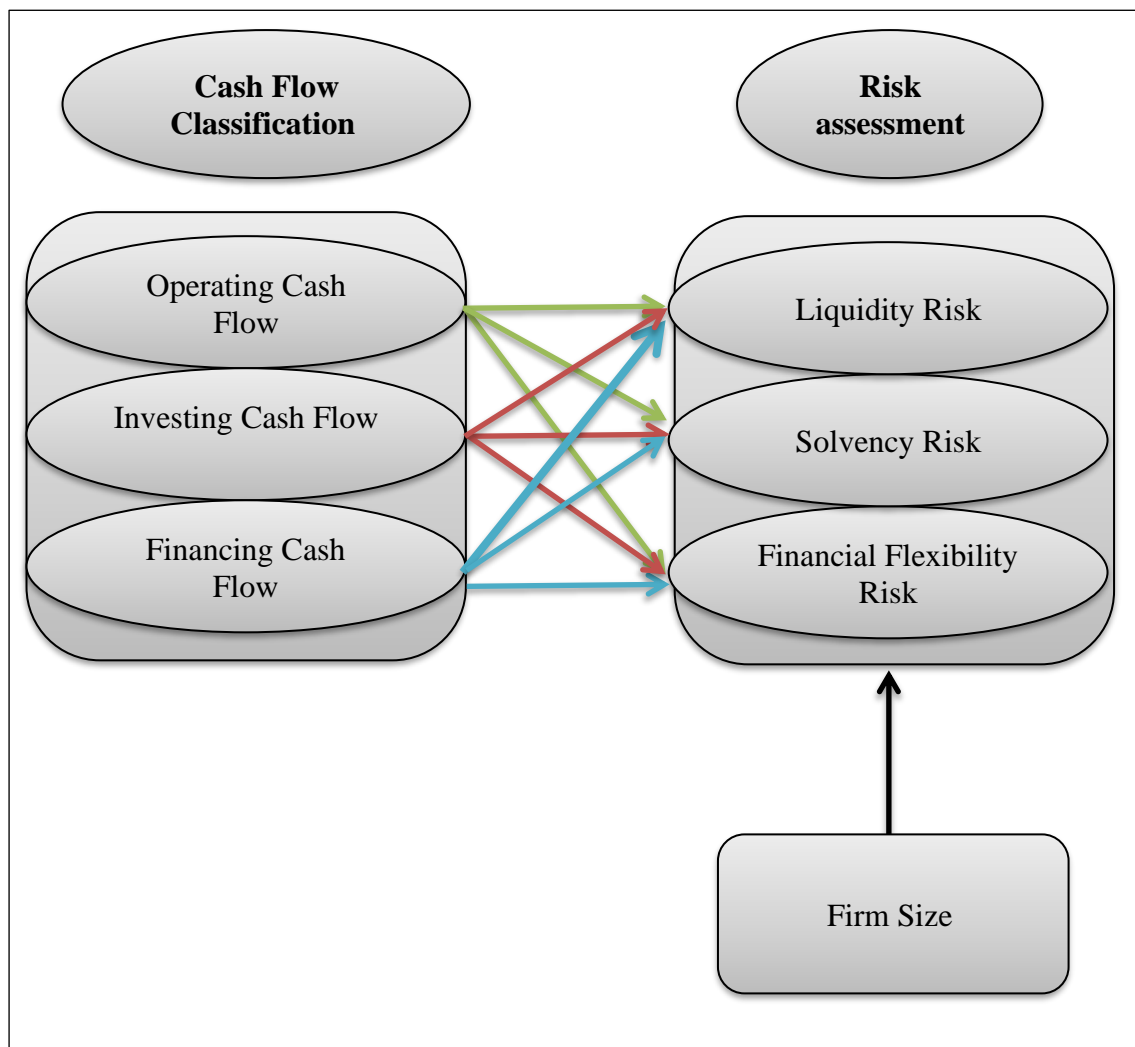
The control variable is firm size. This variable is reported as the amount of total assets in the balance sheet (Chowdhury & Zaman, 2019), commonly measured by the natural logarithm of total assets (Yegon, Mouni, & Wanjau, 2014).

Table (2) in appendix (A) shows the study's variables, Symbol, definitions, how they are measured, and sources from which they are derived.

2.6 Study Model

Figure (7)

Study Model



2.7 Statistical Analysis Methods

The researcher used descriptive statistics, a correlation matrix, and multiple regression analysis to test the hypotheses and process the data.

2.7.1 Descriptive Statistics

This method summarised the data's main characteristics, including the mean, standard deviation, minimum, and maximum values.

2.7.2 Correlation Matrix

This test examined the correlation between independent variables to verify the presence of multicollinearity. Multicollinearity occurs when two or more independent variables are closely related, which may affect the accuracy and stability of the regression results (Isan et al., 2020).

2.7.3 Multiple Regression Analysis

The robust standard errors evaluated the impacts between the several independent factors (financing cash flow, investing cash flow and operating cash flow) and the dependent variable (risk assessment that was measured by liquidity risk, solvency risks as illustrated in table (5) and used the logistic regression to assess the impacts of the same independent factors on the financial flexibility risks as illustrated in table (6) and used the firm's size as a control variable.

2.8 Models

The model was formulated to study the impact of independent variables on dependent variables as follows:

Model 1: Liquidity Risk = $\alpha_0 + \beta_1 \text{FCF} + \beta_2 \text{ICF} + \beta_3 \text{OCF} + \beta_4 \text{FSIZ} + \varepsilon$.

Model 2: Solvency Risk = $\alpha_0 + \beta_1 \text{FCF} + \beta_2 \text{ICF} + \beta_3 \text{OCF} + \beta_4 \text{FSIZ} + \varepsilon$.

Model 3: The risks of financial flexibility = $\alpha_0 + \beta_1 \text{FCF} + \beta_2 \text{ICF} + \beta_3 \text{OCF} + \beta_4 \text{FSIZ} + \varepsilon$.

Where:

α_0 : represents Intercept; β_1 - β_4 represents regression coefficient; FCF: Financial Cash Flow; ICF: Investing Cash Flow; OCF: Operating Cash Flow; FSIZ: Firm Size; ε : error term.

Chapter Three

Study Results

3.1 Descriptive statistics

Table (3) below provides a descriptive, structural summary of all variables used in this study. The mean of OCFR and DTE was 0.407 for the dependent variables. The average value of 0.189 indicates that the firms presented had a moderate mean of DTA. The standard deviation of 1.582 indicates the presence of variation in the level of Winsor CR across the firms studied. However, regarding the control variable, firm size, the minimum and maximum levels were 7 and 10, respectively.

These results indicate the presence of high liquidity among the firms sampled by the study. This figure means that firms have 2.26 units of CA for every unit of CL, indicating that firms have sufficient capacity to meet their short-term obligations. The standard deviation of this ratio was 1.582, indicating high variation between firms.

Also, the statistics indicated the efficiency of a firm's use of its assets to generate OCFs. The result means that firms, on average, generate 40.7 cents of OCF for every dollar of total assets. This is a positive indicator of firm's ability to generate cash flows from their core activities, which enhances their ability to pay their obligations and make the necessary investing. This finding is consistent with Özcan (2020), who concluded that good cash flow management enhanced a firm's survival ability.

The results showed that the mean debt-to-assets and debt-to-equity ratios were acceptable, but significant firm variations indicated a difference in the capital structures followed.

The mean of financial flexibility risk of industrial firms was moderate, but there was significant variation between firms. This discrepancy may indicate differences in firm's size, sectors, and financial strategies.

The arithmetic mean of Winsor OCF was positive, which indicates that the firm's in the sample did not face challenges in achieving positive cash flows from operations. This figure may mean that these firms can control operating expenses. At the same time, the means of Winsor ICF and Winsor FCF were negative, which indicates that the firms in

the sample had difficulties obtaining sufficient external financing and spent more than they invested. This indication means that these firms acquire capital assets.

Table (3)

Descriptive Statistics (n = 905)

Variable	Obs	Mean	Std. Dev.	Min	Max
winsor CR10	905	2.26	1.582	0.677	5.561
OCFR10	905	0.407	0.484	-0.103	1.418
DTA10	905	0.189	0.164	0	.472
DTE10	905	0.407	0.439	0	1.295
TheRisksofFlexibil~y	905	0.085	0.279	0	1
winsor OCF10	905	85384987	1.492e+08	-3175275	4.478e+08
winsor ICF10	905	-25939819	49033075	-1.480e+08	6842822
winsor FCF10	905	-59571281	1.168e+08	-3.526e+08	15649906
size10	905	8.49	1.049	7	10

3.2 Multicollinearity

The correlation matrix in Table (4) shows the pairwise correlations between the variables in the study. A correlation coefficient can range from -1 to +1, where -1 indicates a perfect negative correlation, 0 indicates no correlation, and +1 indicates a perfect positive correlation.

Regarding the independent variables, OCF had a weak positive relationship with CR, DTE, and DTA. The correlation coefficients were 0.097, 0.011, and 0.025, respectively. OCF had a moderate positive relationship with the OCFR with a correlation coefficient of 0.448, while it had a weak negative relationship with the risks of Flex~y with a correlation coefficient of -0.095. Likewise, the ICF had a weak negative relationship with all dependent variables except for RisksofFlex~y, with a correlation coefficient of 0.097.

As seen from the correlation matrix below, Multicollinearity occurs in a multiple regression model when there are significant inter-correlations between independent variables, known as multicollinearity. Multicollinearity, when applied broadly, can lead to predictors having larger confidence intervals and weaker likelihood esteems than predictors that exhibit total multicollinearity. The results of a model with more than 80% correlation coefficient may not always be valid, as shown in subsequent tables.

The greatest value of the correlation coefficients was 81%, which is more than 80%, for correlation coefficient values between the independent variables of OCF and FCF. This result suggests a problem of linear interference (multicollinearity) between the study variables.

Table (4)

Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) CR10	1.000								
(2) OCFR10	0.557	1.000							
(3) DTE10	-0.547	-0.348	1.000						
(4) DTA10	-0.589	-0.387	0.875	1.000					
(5) financial Flexibility Risk	0.084	0.022	-0.088	-0.084	1.000				
(6) ocf10	0.097	0.448	0.011	0.025	-0.095	1.000			
(7) icf10	-0.005	-0.267	-0.078	-0.105	0.097	-0.700	1.000		
(8) fcf10	-0.137	-0.378	0.029	0.027	0.110	-0.817	0.464	1.000	
(9) size10	0.071	0.103	0.080	0.065	-0.109	0.226	-0.242	-0.208	1.000

3.3 Hypothesis testing

3.3.1 Robust standard errors in parentheses to test liquidity and solvency risk with firm size as a control variable

H1: There is no statistical impact at a significance level of $\alpha \leq 0.05$ of cash flow classification on liquidity risk assessment.

The following sub-hypotheses are derived from it:

H1 (a): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of operating cash flow on liquidity risk assessment.

The statistical analysis results in Table (5) indicate a significance level of < 0.05 , indicating that the test model shows the statistical significance of operating cash flow on liquidity risk. This result means that the elements of OCFs affect the liquidity risk of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM. An explanation for this is that cash inflow from operating activities indicates the firm's ability to commit to its short-term

obligations, while cash outflow from operating activities reduces the firm's liquidity and thus decreases the ability to commit to its short-term obligations. This result is consistent with (Özcan, 2020).

Liquidity may be significantly affected by liquidity when the effect of liquidity on liquidity is at a significance level of 5%. Efficient liquidity can be boosted by the influx of cash flows resulting from operational activities. If the company's core operations are profitable, the firm manages its resources efficiently, and the firm achieves sufficient income to cover its operating expenses, which is primarily related to a profitable core business, a favourable balance between good cash flow, liquidity, and vice versa.

H1 (b): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of investing cash flow on liquidity risk assessment.

The regression results listed in Table (5) for testing the hypotheses summarise the result of the second sub-hypothesis. The significance level was <0.05 , meaning the test model indicates a statistically significant effect of ICF measures. This means that the elements of ICFs affected the liquidity risk of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, whether these are investing inflows or outflows. One explanation is that the high cash outflows to acquire assets reduce the firm's liquidity, while the cash inflows from selling assets increase cash, thus increasing a liquidity and the capacity of a business to fulfil its immediate obligations. The researcher agreed with (Esin, 2015) that the existence of a sufficient amount of cash in time increases the accuracy of the decisions.

Increasing the liquidity of a firm through outward cash flows resulting from the purchase or sale of outward assets reduces the firm's liquidity, while converting those assets to inward cash flows generates inward cash flows that contribute to raising liquidity, purchasing assets can lead to a brief period of low liquidity, but it can generate higher financial returns over an extended period. Effective management of investment assets is crucial for boosting liquidity and enhancing financial stability, making it clear that improving liquidity is critical.

H1 (c): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of financing cash flow on liquidity risk assessment.

The regression results listed in Table (5) for testing the hypotheses summarise the result of the third sub-hypothesis. The significance level was <0.05 , which means that the test model indicates a statistically significant effect of FCF measures on liquidity risk. This means that the elements of FCFs affect the liquidity risks of industrial firms listed on eight exchanges, the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, whether these are financing inflows or outflows. One reason might be that increasing cash outflows to pay loan instalments and dividends reduces a firm's liquidity. Issuing bonds and shares to obtain financing increases a firm's liquidity. This argument is consistent with Kapadia, Drehmann, Elliott, & Sterne (2010) finding that the timing of cash in and out flows are crucial for funding liquidity risk.

Liquidity, whether in terms of financing cash flows, liquidity - repayment of loans and interest on them, repurchase of shares or distribution of profits, or not using its borrowed funds efficiently to improve operating and investment cash flows - has a statistically significant inverse effect at a significance level of around 5%. All of these matters account for the existence of this inverse relationship that is apparent in liquidity and vice versa.

According to the above, the researcher answered the main first question, which aligns with many studies showing an impact of cash flow classification on liquidity risk assessment.

H2: There is no statistical impact at a significance level of $\alpha \leq 0.05$ of cash flow classification on solvency risk assessment.

The following sub-hypotheses are derived from it:

H2 (a): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of operating cash flow on solvency risk assessment.

The regression results listed in Table (5) for testing the hypotheses summarise the result of the first sub-hypothesis. The significance level was <0.01 , meaning the test model indicates a statistically significant effect of operating cash flow measures on solvency risks. This result means that the elements of OCFs affected the solvency risks of industrial

firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, whether they are in or out operational flows. One possible reason for this result is that positive operating cash flows indicate a firm's ability to generate profits from its main operations. This ability to generate profits strengthens a firm's financial position. It improves its financial solvency, while negative OCFs indicate a firm's inability to generate profits from its main operations and, thus, threaten its financial solvency.

The cost-to-income ratio and advances net of provisions to total assets ratio are considerably negatively correlated with banks' financial stability. However, OCFs and net interest margin significantly and favourably influenced banks' financial stability (Mustahsan, Habib, Muhammad, & Ali, 2021).

A statistically insignificant inverse relationship exists between liquidity and operating cash flows:

H2 (b): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of investing cash flow on solvency risk assessment.

The regression results listed in Table (5) for testing the hypotheses summarise the result of the second sub-hypothesis. The significance level of the debt-to-assets ratio = -0.000145 and the significance level of the debt-to-equity ratio = -0.000290, which means that the test model indicates a statistically significant effect of investing cash flow measures on solvency risks. This means that elements of ICFs affect the solvency risks of industrial firms listed on eight exchanges, the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, whether they are investing flows are in or out. This may be because the increase in cash outflows allows the acquisition of assets, increasing a firm's investing and thus improving a firm's financial performance in the long term. This process enhances a firm's financial solvency. Conversely, an increase in inflows indicates the sale of assets, reducing a firm's investing and threatening its long-term sustainability and financial solvency.

Cash inflows lead to asset sale, which is a sign of impairment at the significance level of 1% and 5%, reducing investments and posing a threat to their sustainability and solvency in the long run. Another explanation is that future financial obligations may be exempt

from this advantage, and borrowing to invest increases future financial obligations, which in turn reduces solvency. Some may suggest that the reason behind this is due to the associated risks - market risks such as low demand, which can leave an investor exposed to market risks, and thus not yielding the anticipated return, ending up in the wrong direction and thereby decreasing solvency.

H2 (c): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of financing cash flow on solvency risk assessment.

The regression results listed in Table (5) for testing the hypotheses summarise the result of the third sub-hypothesis. The significance level was < 0.05 , which means that the test model indicates a statistically significant effect of FCF measures on financial solvency. This result means that elements of financing cash flows affect the solvency risks of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM, whether financing flows are inwards or outwards. One explanation for this result is that the increase in cash outflows to pay loan instalments reduces the cash available to finance investing and thus threatens financial solvency, while the increase in cash inflows indicates obtaining financing through the issuance of stocks and bonds. This inflow enhances the capital structure and thus improves a firm's continuity and financial solvency in the long term. Also, according to Masero & Manjón (2020), information derived from cash flow statements is useful when assessing whether a firm can be classified as solvent or insolvent in the future.

The issuance of stocks, bonds, and loans creates financial resources and liquidity for the firm to meet its obligations, which improves its financial position and reduces the risk of default. Another possibility is that regular and robust financing cash flows send a signal to investors and creditors, indicating that the firm is solvent and increasing its financial rating.

According to Gryglewicz (2011), a firm is illiquid if it cannot pay its obligations at any time. If its value falls below its debt, a firm becomes insolvent and defaults.

Additionally, it has been demonstrated that the coefficients of determination of independent and control variables for liquidity risk as a current ratio were 0.058, while the coefficient of determination of the OCF ratio was 0.261. Related to solvency risk, the

coefficients of determination of the debt-to-assets ratio and debt-to-equity ratio were 0.061 and 0.037, respectively.

According to the above, the researcher answered the main second question. The results were consistent with many studies, indicating that cash flow classification impacts solvency risk assessment.

Table (5)

Multiple Regression

	(1)	(2)	(3)	(4)
VARIABLE	Current ratio	OCF ratio	Debt to assets ratio	Debt to equity ratio
OCF	0.000111 (0.000109)	***0.000634 (6.6505)	6.1606- (2.7005)	2.1405- (6.3605)
ICF	**0.000379 (0.000205)	0.000199 (0.000142)	***0.000145- (5.4505)	**0.000290- (0.000137)
FCF	***0.000292- (0.000113)	0.000107- (e-056.86)	**6.4905 (2.8805)	**0.000136 (6.8705)
Firm Size	**0.0610 (0.0258)	**0.0318 (0.0154)	0.00642 (0.00680)	0.0194 (0.0188)
Year fixed effect	Yes	Yes	Yes	Yes
Country fixed effect	Yes	Yes	Yes	Yes
Constant	34.90- (65.17)	***129.2- (40.98)	15.38 (16.29)	31.29 (38.54)
Observations	904	904	905	905
R-squared	0.058	0.261	0.061	0.037

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.

3.3.2 Logistic regression to test the financial flexibility risk because this is panel data

H3: There is no statistical impact at a significance level of $\alpha \leq 0.05$ of cash flow classification on financial flexibility risk assessment.

The following sub-hypotheses are derived from it:

H3 (a): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of operating cash flow on financial flexibility risk assessment.

The Logistic regression results in Table (6) were significant at 0.00141, indicating that the test model shows a statistical significance of OCF on the FFR assessment. This means

that OCF elements affect the FFR of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM. This is because International Accounting Standard 7 allows firms to classify interest paid and dividends received as OCFs for financial organisations. Alternatively, interest paid, interest and dividends received can be classified as FCFs and ICFs, respectively. The variable of tax classification was constant, which means that all firms classify the tax as cash flow from operation. According to International Accounting Standard No. 7, taxes paid are classified as cash flows from operating activities, except when they can be practically determined as cash flows from financing and investing activities.

H3 (b): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of investing cash flow on financial flexibility risk assessment.

The logistic regression results listed in Table (6) were significant at 0.00428, which indicated that the test model shows the statistical significance of ICF on the FFR assessment. This result means that ICF elements affect the FFR of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM. This is perhaps because international accounting standards allow firms to classify interest paid and dividends received as financing or investing cash flows according to their purpose. Interest and dividends received can be classified as investing cash flows if they are returns on investments.

H3 (c): There is no statistical impact at a significance level of $\alpha \leq 0.05$ of financing cash flow on financial flexibility risk assessment.

The logistic regression results in Table (6) were significant at 0.00268, indicating that the test model shows a statistical significance of FCF on FFR. This result means that the elements of financing cash flows affect The Risks of Flexibility of industrial firms listed on eight exchanges, including the PEX, the ASE, the QSE, the KSE, the MSM, the SSE, the BHB, and the DFM. This is perhaps because international accounting standards allow firms to classify interest paid and dividends paid as financing or investing cash flows according to their purpose. Interest and dividends paid can be classified as financing cash flows if these are the costs of obtaining financial resources.

Primary factors that determine OCF enhancing classification options include incentives from the capital markets and lead to a chance of financial crisis. Some evidence that analyses the effect of reporting financial flexibility demonstrates that a firm's classification decisions affect how the market judges the permanence of operating cash flows and accruals (Gordon et al., 2017).

According to the above, the researcher answered the main third question, consistent with many studies showing the impact of cash flow classification on FFR assessment.

Table (6)

Logistic Regression

Variable	(1) Logistic regression Financial Flexibility Risks
OCF	**0.00141 (0.000694)
ICF	**0.00428 (0.00173)
FCF	***0.00268 (0.000877)
Firm Size	**0.300- (0.129)
Year fixed effect	Yes
Country fixed effect	Yes
Constant	***1,490- (499.6)
Observations	905

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Chapter Four

Conclusion and Recommendations

4.1 Overview

This chapter presents the conclusion and recommendations of the study.

4.2 Conclusion

1. There is a statistically significant effect of the classifications of operating, investing and financing cash flows on the risk assessment of the shares of public industrial shareholding firms listed on eight exchanges including the PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM and this consistent with (Esin, 2015; Gordon et al., 2017; Gryglewicz, 2011; Kapadia et al., 2010; Masero & Manjón, 2020; Mustahsan et al., 2021; Özcan, 2020).
2. The results indicated that the tested firms have sufficient capacity to meet their short-term obligations. The descriptive statistics indicated that firms have 2.26:1 units of current assets for every unit of current liabilities.
3. The statistics analysis indicated a positive indicator of firm's ability to generate cash flows from their operating activities, which enhances their ability to pay their obligations and make the necessary investments. The analysis also indicated the efficiency of using assets to generate operating cash flows in the industrial firms tested in this study.
4. Consistent with Esin (2015), liquidity, solvency, and financial flexibility are related to providing sufficient cash in time, so using a cash-based statement increases the accuracy of decisions.

4.3 Recommendations

4.3.1 General Recommendations

1. The firms should examine how the macroeconomic environment affects cash flows by examining the impacts of economic growth rates, inflation, and interest rates.
2. It is necessary to re-conduct such a study on financial firms to investigate the impact of cash flow classifications that relate to taxes, dividends, and interests on financial flexibility risks. This study should be applied to 2023 data to analyze the cash flow

and risk response of cash flows and risks to the wars and financial crises that Palestine is facing in particular and to the economic fluctuations that the world is facing in general.

4.3.2 Specific Recommendation

Public industrial shareholding firms listed on eight exchanges, including the PEX, ASE, SSE, MSX, KSE, QSE, BHB and DFM, are required to maintain a suitable level of liquidity; the industrial index serves as a gauge for the firm's level of liquidity. A firm's liquidity ratio must not exceed the industrial index to prevent financial resources from being squandered without yielding a return. Liquid ratios cannot drop below the industrial index to keep the business from liquidity trouble and align funding sources with methods of employing these sources to protect against liquidity risks.

List of Abbreviations

Abbreviations	Meaning
OCF	Operating Cash Flow
ICF	Investing Cash Flow
FCF	Financing Cash Flow
LR	Liquidity Risk
SR	Solvency Risk
FFR	Financial Flexibility Risk
PEX	Palestine Exchange
ASE	Amman Stock Exchange
SSE	Saudi Arabia Exchange
MSX	Muscat Stock Exchange
KSE	Kuwait Stock Exchange
QSE	Qatar Stock Exchange
BHB	Bahrain Bourse
DFM	Dubai Financial Market

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Appendices

Appendix (A)

Figures

Table (2)

Study Variables

Variable	Symbol	Definition	Measurement	References
<i>Dependent variable</i>				
Liquidity Risk	LR	The failure of the business to meet its responsibilities when it matures means the firm's inability to meet short-term obligations (current liabilities) from its cash and other current assets.	<ul style="list-style-type: none"> • Current ratio = Total current assets / Total current liabilities • Operating Cash Flow Ratio = Cash Flow from Operations / Current Liabilities 	(Dika et al., 2022; Esin, 2015; Kunghehian & Moss, 2017; Ramadan & Fahmi, 2020).
Solvency Risk	SR	When a firm is fundamentally unable to meet its long term obligations, including its obligations to its creditors, i.e. unable to cover losses resulting from all types of risks that threaten financial firms, it is said to be insolvent.	<ul style="list-style-type: none"> • Debt to Equity Ratio = total debt/equity • Debt to Assets Ratio = total debt/total assets 	(Gennaro, 2021; Satryo et al, 2016).
Financial Flexibility Risk	FFR	The adaptability of classifying some items—primarily interest, dividends, and taxes—as operating, investing or financing activities	<p>The financial flexibility is zero if the firm classifies interest paid, dividends paid in financing cash flow as of the last year reported and one if otherwise.</p> <p>The financial flexibility is zero if the firm classifies tax paid in operating cash flows as of the last year reported and one otherwise if it is not practical to determine its nature.</p>	(Al Hasnawi, 2018; Wei et al., 2017).
<i>Independent variables</i>				
Operating cash flows	OCF	The main revenue-producing activities of an entity that are not investing or financing activities. This includes cash received from customers and cash paid to suppliers and employees.	The reported cash flow from operating activities	(IASB, 2023; Lateef et al ., 2023)

Investing cash flows	ICF	It is cash flows related to the purchase and disposal of long-term assets and other investing that are not considered to be cash equivalent.	The reported cash flow from investing activities	(Wei et al ., 2017)
Financing cash flows	FCF	Activities that alter the equity capital and borrowing structure of the entity. The entity's long-term capital and debt structure are altered by its operations.	The reported cash flow from financing activities	(Akumu, 2014; Ugo & Egbuhuzor, 2022)
<i>Control variable</i>				
Firm Size	FI_SIZE	The natural logarithm of total assets	The natural logarithm total assets measure it.	(Afiezan et al., 2020; Chowdhury & Zaman, 2019; Asmar et al., 2024' Abu Alia et al., 2024)



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الملخص

هدفت هذه الدراسة للتعرف على تأثير تصنيفات التدفقات النقدية على تقييم المخاطر للشركات الصناعية (غير المالية) المدرجة في بورصات فلسطين، عمان، السعودية، مسقط، الكويت، قطر، البحرين، دبي، وسعت الدراسة لتحقيق عدة أهداف منها: تحديد أثر تصنيفات التدفقات النقدية المتمثلة في الانشطة الرئيسية (التشغيلية، التمويلية والاستثمارية) على تقييم مخاطر (السيولة، الملاءة والمرونة المالية). وتكونت عينة الدراسة من 181 شركة صناعية للفترة الممتدة بين (2018-2022) وقد تم استخدام المنهجان الوصفي والتحليلي، وقد تم اجراء الانحدار الخطي المتعدد وفقا لطريقة التأثيرات الثابتة.

وبينت نتائج هذه الدراسة أنه يوجد أثر ذو دلالة احصائية لتصنيف التدفقات النقدية التشغيلية، التمويلية والاستثمارية على مخاطر السيولة، الملاءة والمرونة المالية كما أشارت نتائج الدراسة أن الشركات لديها سيولة وكفاءة في استخدام الاصول لتوليد النقدية. وفي ضوء ذلك أوصت الدراسة أنه يجب الحفاظ على مستوى مناسب من السيولة.

الكلمات المفتاحية: التدفقات النقدية، مخاطر السيولة، مخاطر الملاءة، مخاطر المرونة المالية.