

Valuation Relevance and Disaggregations of Earnings and Book Value

Andrew W Stark (Manchester Business School)

Accountants have long accepted that partitioning of earnings and book value is a useful exercise. For example, earnings are partitioned into revenues and expenses, with expenses partitioned into cost of goods sold, interest, taxes, etc. Book value is partitioned into assets and liabilities, with each of assets and liabilities split into current and non-current portions.

The purpose of this paper is to investigate the value relevance of such partitions. The earnings partition we investigate is the cash flow/current accruals/non-current accruals partition. In previous literature, the value relevance of cash flow versus accruals data has tended to be investigated within the framework of looking at the impact of such partitions on stock market returns. These results seem to suggest that cash flow data has some separate value relevance relative to accruals. Nonetheless, other methods of establishing value relevance are becoming more accepted. In particular, cross-sectional valuation models are increasingly being used to consider the valuation relevance of various accounting measures. The value relevance of cash flow versus accruals data has not been investigated to date in the UK from a valuation perspective. This is the first purpose of our paper. By so doing, we hope to shed further light on the value relevance of cash flow measures of performance (and, by implication, comparable disclosures).

Additionally, however, we are interested in establishing the value relevance of partitions of book value. Here, we investigate whether partitioning book value into fixed assets, net current assets and long-term liabilities is value relevant. Such partitioning has been a longstanding practice in accounting. Nonetheless, as far as we know, no systematic investigation has ever taken place into whether it is a useful practice from a valuation perspective. As a consequence, a second purpose of the paper is to shed light on the usefulness of this particular practice of partitioning book value, from a valuation perspective.

Correspondence Details

Andrew Stark
Manchester Business School
Booth Street
West Manchester M15 6PB
United Kingdom

Email: astark@man.mbs.ac.uk