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THE PREDICTIVE ABILITY AND CLASSIFICATION SHIFTING OF DISCONTINUED OPERATIONS UNDER IFRS – 5

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“Life isn’t about finding yourself. Life is about creating yourself.”

- George Bernard Shaw
I dedicate this dissertation to my beloved mother, who has quietly stood by and made sacrifices while showering me with unconditional love and support through all the years I pursued an academic career. It is also dedicated to my honoured father, who is no longer with me. There is no doubt he would have been so proud of his daughter’s latest achievement. To them I shall forever be indebted.

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ABSTRACT

Considerable attention has been directed towards the impact of International Financial Reporting Standards (IFRS) by the business community and regulators. IFRS-5 Non-current Assets Held for Sale and Discontinued Operations requires the separate reporting of discontinued operations in the statement of comprehensive income. This is based on the (untested) assertion that cash flows from discontinued operations are different from continuing flows. Thus, there is a need to provide empirical evidence to support the assumption.

This thesis examines the usefulness of separate reporting of discontinued operations in two important attributes: predictive ability and classification shifting. Motivated by the concerns that discontinued operations are not useful to predict future profitability and are used to manipulate core earnings, this thesis investigates these two aspects for Australian listed companies that have adopted IFRS since 2005.

Existing literature documents evidence that discontinued operations should be ignored to predict future profitability (Fairfield, Sweeney, & Yohn, 1996) and managers engage in classification shifting using discontinued operations (Barua, Lin, & Sbaraglia, 2010) under the United States’ Generally Accepted Accounting Practices (US GAAP). As discontinued operations are defined and measured differently under US GAAP and IFRS, this thesis investigates the usefulness of separate reporting of discontinued operations under IFRS by examining predictive ability and classification shifting of discontinued operations.

The findings show discontinued operations, particularly when splitting it into gains and losses from discontinued operations, are useful to predict a company’s future profitability. Furthermore, results show losses from discontinued operations are opportunistically used to manipulate core earnings, to avoid reporting losses and earnings decreases under IFRS, when firms report discontinued operations frequently, and the amount of losses is high.

These results could be used for IASB in deciding whether to report discontinued operations separately in statements of comprehensive income.
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LIST OF ACRONYMS

APE  Absolute Percentage Errors  
AFE  Absolute Forecasted Errors  
ASC  Accounting Standards Codification  
ASU  Accounting Standard Update  
CE  Core Earnings  
DCO  Discontinued Operations  
EPS  Earnings Per Share  
FASB  Financial Accounting Standard Board  
GAAP  Generally Accepted Accounting Practices  
GCU  Cash Generating Unit  
IAS  International Accounting Standards  
IASB  International Accounting Standard Boards  
IASC  International Accounting Standard Committee  
IFRIC  International Financial Reporting Interpretations Committee  
IFRS  International Financial Reporting Standards  
MAPE  Mean Absolute Percentage Error  
MoU  Memorandum of Understanding  
SEC  Security Exchange Commission  
SFAS  Statement of Financial Accounting Standards  
US  United States  