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**THE CONTEMPORANEOUS MOVEMENT
BETWEEN CASH FLOW AND ACCRUALS-BASED
ACCOUNTING NUMBERS: THE NEW ZEALAND
EVIDENCE**

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John Dowds

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ABSTRACT

Much attention has been focused on the *usefulness* of cash flow numbers as variables used in predicting the *future* cash flows of an entity. Paradoxically, little attention has been paid to how earnings move relative to cash flows over a sustained time period. This thesis addresses the issue and analyses the financial information from the annual reports of New Zealand listed companies for the 21 year period, 1971-1991. The evidence shows that there has been wide variation between earnings and the underlying cash flows during the 1980s. The two years following the 1987 stock market collapse appears to have had a reduced degree of variation between the earnings and cash flow variables. This suggests that post-crash the attention on financial reporting was influential in reducing the degree of variation between earnings and the underlying cash flows.

The study also examines the data scaled and with outliers removed. Scaling indicates that non-current accruals are more important for large companies while removal of outliers has little effect on the results.

Data on actual cash flows were analysed for the period 1989-1991. The results indicate that the variation between earnings and actual cash flows is quite high.

The contextual relationship between changes in each of the accounting variables (earnings and cash flows) and changes in macroeconomic indicators (gdp, money supply and inflation) was investigated. The evidence is that the association between changes in the macroeconomic indicators and changes in the accounting variables is not particularly strong and that changes in both money supply and inflation are of more importance than changes in gdp.

An industry by industry analysis provides evidence showing that for most industries there is little association between changes in the accounting variables and changes in economic indicators. There is evidence that some industries are more sensitive than others to macroeconomic changes. This evidence is enhanced when the data are partitioned in a way which allows low, medium and high changes in macroeconomic activity to be analyzed separately.

The conclusion of the study is that although the largest proportion of variation in accounting numbers is explained by factors other than changes in the economy there is sufficient evidence to suggest that for some industries the impact of changes in macroeconomic conditions is greater than for others.

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