VOLATILITY, VALUE RELEVANCE AND PREDICTIVE POWER OF COMPREHENSIVE INCOME

A thesis submitted in partial fulfilment of the requirements for the degree of

Doctor of Philosophy

in

Accounting

at Massey University, Albany,

New Zealand

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2012
ABSTRACT

Despite analysts’ demands for (and standard setters’ preferences for) a single statement of comprehensive income, both the IASB and the FASB have not been able to achieve this objective. Proponents of a single statement presentation argue that comprehensive income brings discipline to managers and analysts as it requires them to consider all factors affecting owners’ wealth. Opponents argue that other comprehensive income items are transitory in nature, including them with core business earnings increases the volatility and reduces the predictive power of earnings. Thus, this thesis examines the volatility, value relevance and predictive power of comprehensive income relative to net income. Motivated by the concerns that the volatility of comprehensive income leads to the perception of increased risk, this thesis investigates the volatility and risk relevance of comprehensive income for a sample of non-financial United States (US) and New Zealand (NZ) firms. The findings show that comprehensive income is more volatile than net income. The findings also show that comprehensive income volatility is associated with market-based measures of risk (volatility of stock returns and beta). However, the incremental volatility of comprehensive income (over net income) is not associated with market risk and is not priced. Prior literature documents mixed evidence on the pricing of comprehensive income. The mixed results are attributed to the use of as if measures of comprehensive income, which introduces measurement error. This thesis uses as reported data from US and NZ firms and shows that comprehensive income is more value relevant compared to net income. However, net income is a better measure for predicting future operating cash flows and future net income. These results have important implications for the FASB/IASB in deciding whether to report comprehensive income in a single statement of performance.
ACKNOWLEDGMENTS

With great pleasure, I would like to thank those without whose support; I would have never been able to achieve the herculean task of completing this PhD thesis.

I am thankful to Allah Almighty for giving me the strength and courage to achieve this humongous milestone. After that special thanks goes to my principal supervisor, Professor Michael E. Bradbury, whose enormous help and support throughout, has been the guiding light whenever I have tumbled down on the path to doctorate. I am, and will always be, indebted to him for his creative ideas and constructive criticism. I am grateful to my co-supervisor, Associate Professor Stephen M. Courtenay for his wisdom and valuable input at all times. It has been a real privilege to be supervised by such dynamic, well-versed and learned supervisors. The support and encouragement I received from other faculty like Professor Asheq Rahman, Professor Jill Hooks and my Head of Department, Professor Fawzi Laswad is truly commendable.

I would like to extend my gratitude to the Higher Education Commission, Pakistan, for providing me financial support, which has been one of the key ingredients in this whole doctoral journey. I am also thankful to the Accounting & Finance Association of Australia and New Zealand, for the 2010/2011 research grant. I appreciate the help and support I received from my friends, particularly, Inshah, Adnan and Cai Lei, for helping me with statistics. I would like to express my deepest gratitude to my family. Especially the two most important women in my life: my mother and my wife. Without whose unwavering support and unconditional love, I would have been lost in the wilderness of nothingness. Last but not least; I am grateful to the one whose cutest smiles made this arduous PhD journey a cheerful one. The joy of my life, my lovely daughter Vadana.
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<th>Description</th>
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<tbody>
<tr>
<td>AAA</td>
<td>American Accounting Association</td>
</tr>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>APB</td>
<td>Accounting Principles Board</td>
</tr>
<tr>
<td>ARB</td>
<td>Accounting Research Bulletin</td>
</tr>
<tr>
<td>ASRB</td>
<td>Accounting Standards Review Board</td>
</tr>
<tr>
<td>ASU</td>
<td>Accounting Standard Update</td>
</tr>
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<td>CAP</td>
<td>Committee on Accounting Procedure</td>
</tr>
<tr>
<td>EAA</td>
<td>European Accounting Association</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
</tr>
<tr>
<td>FRS</td>
<td>Financial Reporting Standard</td>
</tr>
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<td>FRSB</td>
<td>Financial Reporting Standards Board</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Practice</td>
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