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University of Technology in fulfilment of the
degree of Doctor of Philosophy

**Accruals: Signalling or Misleading?
Evidence from New Zealand**

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Abstract

Studies on earnings management usually hypothesise that managers manage accruals opportunistically. Few studies however, argue that managers can also use accruals to improve the value relevance of reported earnings to help investors better assess the firm's operating performance. While substantial evidence on managers' opportunistic behaviour on accruals has been documented in the literature, empirical evidence on the informativeness of accruals is scarce and inconclusive. The purpose of this thesis is to examine whether managers use accruals to communicate private information regarding the firm's operating performance, or as reported in the literature, use them for their own benefit.

This thesis finds that on average, firms reporting high earnings accompanied by high accruals have significantly negative subsequent period stock returns suggesting that these firms *manage* their accounting earnings. Focusing on stock dividend issues as an incentive to opportunistically increase accruals, the results are found to be consistent with the earnings management hypothesis. Stock dividend issuing firms are reported to significantly increase accruals in the issue year followed by poor earnings and stock price performances in the subsequent year. Moreover, discretionary accruals of the issuing firms are negatively correlated with both future earnings and abnormal stock returns. This evidence attempts to complement the earnings management literature. The analysis on the incentive to decrease accruals related to share repurchases, however, does not provide sufficient evidence to suggest that managers use their discretion to decrease accruals.

To investigate the hypothesis that managers use accruals to convey information regarding their firm's future profitability, this thesis employs the contemporaneous earnings and dividend announcements as the research setting. This choice was made to increase the likelihood of detecting the use of accruals as private information communication while simultaneously mitigating the likelihood of the opportunistic income smoothing hypothesis to explain the results. The evidence

strongly indicates that managers use both accruals and dividend increases as their private information communication regarding their firm's future profitability. Dividend increasing firms report positive accruals which are positively correlated with future profitability. This finding contributes to the literature by providing evidence on the accrual signalling hypothesis.

Overall, the results of this thesis suggest that, depending on the incentives, managers can use the discretion accorded under the Generally Accepted Accounting Principles (GAAP) in estimating accounting accrual, either to manage accruals opportunistically or to help investors better assess the firms' operating performance.