

ABSTRACT

Prior research suggests that the quality of accruals may be compromised where the magnitude of accruals is abnormally high, due to the presence of errors in the accruals-estimation process (Dechow and Dichev, 2002; Richardson, 2003). A consequence of this is that abnormal accruals may not map into realised future cash flows to the extent that would normally be expected of accruals data. Indeed, the association may be insignificant if abnormal accruals consist primarily of estimation noise. My Study investigates whether abnormal accruals for Indonesian firms provide incremental insight into future cash flows. In particular, our paper may be viewed as a development of Subramanyam (1996). We find a significant positive association between abnormal accruals and one-year-ahead operating cash flows. This provides a rationale for the pricing of abnormal accruals by the market (Subramanyam, 1996; Xie, 2001) and suggests that abnormal accruals are not merely the products of noise in the accruals-estimation process. However, our results are conditional upon the probability of one-year-ahead bankruptcy risk (Altman et al., 1968). We also find that abnormal accruals possess small but significant explanatory power for future cash flows even when controlling for the disaggregation of accruals into individual items (Barth et al., 2001).

Key words: earnings quality; bankruptcy risk; operating cash flows; future cash flows; abnormal accruals; working capital accruals

