

**VALUE RELEVANCE OF ACCOUNTING NUMBERS
FOR VALUATION**

by

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ABSTRACT

Recent empirical work suggested that the ability of accounting numbers to explain the relationship between accounting numbers and stock prices over the past four decade [Collins, Maydew and Weiss [1997]; Francis and Schipper [1999]; and Lev and Zarowin [1999]] has deteriorated. This provide the key motivation for this study to examine the relationship between accounting numbers and stock price in the Malaysian emerging capital market which is useful for firm valuation.

The findings of this study suggest that the accounting earnings and book value are capturing most of the information that is relevant to assess the values of firms and at the same time, it also suggests a decline in their value relevance after the financial crisis period. The results also suggest that accounting earnings and book value as well as non-accounting beta are more valued during the financial crisis period as compared to the after-effect of the financial crisis period. Overall, the accounting estimate of the value of the firm is not deviating from the markets' estimate, which indicates that accounting numbers continues to play the central role in the determination of stock prices.

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

One of the common functions assigned to accounting is the provision of relevant information to enable investors to value security and make rational investment decisions. Since the late 1960's, capital markets research in accounting represents a significant area of research within the accounting discipline. One of the main groups of literature within capital markets research is the so-called value relevance literature that seeks to determine the degree to which a given accounting number affects firm valuation. The impact of the stock price on accounting numbers originated from the work of Ball and Brown [1968] and Beaver [1968] who were motivated by the theory that financial statements must have some worth to shareholders since they have survived for so long and financial resources were required to produce them.

Claims in the professional and academic literature that accounting information had lost its relevance, or was in danger of losing it, has served as a motivation for a pool of literature that uses a variety of research designs to assess whether this, in fact, is the case. These concerns also provide the key motivation for this study to find out whether the association between accounting information and stock prices has deteriorated in the Malaysian emerging market.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

The pool of literature that examines the relationships between financial statement information and the capital markets encompasses a number of lines of research in the accounting and finance literature. Capital market research in accounting has grown rapidly over the past three decades and now forms a key area of research that significantly contributes to the major journals with over one thousand published papers [Kothari, 2001].

According to Kothari [2001], one of the four primary areas of capital markets research is fundamental analysis and valuation which examines the relationship between accounting information and stock returns in a value relevance setting. The intuition underpinning this literature suggests that the accounting function provides information that reflects the performance of an organization and consequently should be reflected in stock prices, this metric being the relevant market measure of returns of stockholders. Therefore, accounting information should be relevant and useful for investors in pricing stocks and their asset allocation decisions.

The accounting variable that has received the most attention in this area of the literature is accounting profits. This is due to its high visibility as the 'bottom line' summary measure of performance and is commonly published and sighted in the media and in financial reports.