Underlying profit in New Zealand

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Abstract

Purpose

This paper aims to identify and explain the composition, determinants, relevance and effects of underlying profit and emphasis placed on underlying profit in annual reports.

Design/methodology/approach

The paper uses multivariate analysis of data from New Zealand listed companies from 2006 to 2010 disclosing both generally accepted accounting principles (GAAP) profit and underlying profit. Value relevance is measured in relation to annual stock returns of companies.

Findings

Tax, financial cost and depreciation and amortization are the three main items excluded from GAAP profit to derive underlying profit. Firms that have lower audit quality and industries prone to higher price fluctuation of assets and higher depreciation and amortization expenses use underlying profit. Also, underlying profit is used by firms with higher differences between statutory and target profits, higher analyst following and higher proportion of independent board of directors. Underlying profit has a weak negative association with annual market returns and significant positive association with volume of shares traded. Finally, the relevance of underlying profit is lower for firms that emphasize underlying profit in their annual reports.

Practical implications

Underlying profit is negatively related to the economic performance of the company in the market, whereas GAAP

New Zealand has experienced a sharp increase in the use of underlying profits in annual reports. This research adds to our understanding of the use of underlying profit by New Zealand listed companies.

Keywords

Composition
Determinants
Relevance
Non-conforming financial information
Underlying profit/earnings

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