

The Predictability of FASB and IASB Operating Cash Flow

Rick Francis
University of Northern Iowa

Karen Nunez
North Carolina State University

This study illustrates how the implementation of certain International Accounting Standards Board (IASB) cash flow reporting requirements would affect constituents of the Financial Accounting Standards Board (FASB). The joint international convergence project between these two standard-setters calls for research relevant to differences between the two reporting models. IASB operating cash flows exclude development costs associated with R&D expenditures, as well as interest or borrowing costs and interest income. The IASB's principles-based approach to financial reporting also reduces the acceptability of operating leases, and increases operating cash flow by reclassifying these costs as financing cash flows. This study uses FASB constituent data to generate a pro-forma IASB operating cash flow measure, then compares the out-of-sample predictability of this measure with the FASB cash flow measure as specified in SFAS 95. The out-of-sample, size-, industry-, and sign-matched results indicate that historical pro-forma IASB operating cash flows predict future operating cash flows more accurately than their FASB counterparts. A pro-forma IASB earnings components model (i.e. cash flows and individual operating accruals) also demonstrates greater cash flow forecast accuracy than the FASB model. One implication of the results of the study is that the adoption of certain IASB reporting standards into the FASB reporting model may improve the efficiency of the capital markets by permitting investors to reduce the uncertainty associated with the firm's future core cash flows.
