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Book Review

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Accounting, Cash Flow and Value Relevance

Francesco Paolone, Springer, 2020

by Rosa Lombardi*

In the last decades, the accounting debate has been expanded by several key investigations and reflections among which the value relevance of accounting information and its determination through the mandatory (financial) annual reports and some pillars (e.g. cash flow, book value and earnings) (Clacher et al., 2013; Cotter, 1996; Filip et al., 2021; Kadri et al., 2009). Searching for "accounting", "value relevance" and "cash flow" through the Scopus database (www.scopus.com), the publication trend of studies on this thrilling topic increased especially by the late 2000s. Additionally, a large amount of studies (more than 19,000 documents) is retrieved through Google Scholar (www.scholar.google.com) discussing emerging issues in the value relevance topics.

In this scenario, the book review here developed is intended to represent key issues by accounting, cash flow and value relevance discussing the role of the annual report and financial information provided to all stakeholders. Particularly, Paolone argues the documents included in the mandatory annual report (e.g. financial statement, income statement and so on) concerning accounting information disclosed to stakeholders among which investors requirements assume a relevant role.

Thus, Paolone discusses the balance sheet (or financial statement) and income statement as relevant in drafting the corporate market value; on the other side, the Author presents the determination of the value relevance especially concerning the cash flow statement as a key point (Barth et al., 2005; Kumar and Krishnan, 2008; Ohlson, 1995). The analysis of the book by Paolone here reviewed mainly proposes the discussion of the cash flow statement (also through the "operating cash flow" or OCF) concerning the market value of companies using evidence by the European scenario.

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The book's Author contributed to a wide academic debate focused on the accounting-based valuation theory by Ohlson (1995) achieving these aims "*how the combination between accrual and cash-based information leads to a greater value relevance of the European listed companies… the effects produced by the introduction of a cash measure using two steps of statistical regressions and interpreting results in the empirical chapter…testing the value relevance of accruals and cash-flow information in the European context, covering the last available year of 2018*" (p. 3).

The book by Paolone proposes a clear book structure and an interesting research aim, offering benefits to the readers in presenting results. The book is composed of six chapters, after the introduction in which Paolone argues the aims of the book and motivations for this analysis. The chapter of the book titled "The Cash Flow Statement under IAS/IFRS" is firstly devoted to showing the history of cash flow statements and their content under International Accounting Standards (IAS) both 1 and 7.

In the chapter, the path towards the cash flow statement and classification of cash flow are described to compose the background for the corporate disclosure initiative ("Disclosure Initiative") under IAS 7. Thus, the offsetting of cash flows is proposed in the chapter. Paolone concludes, among the other reflections, that "*The Cash Flow Statement is an integral part of all sets of financial statements prepared in accordance with international accounting standards, as are the balance sheet, the income statement, the statement of changes in shareholders' equity, and the explanatory notes*" (p. 21).

The chapter titled "The Historical Background of Cash Flow Statement: First Evidences and Contributions" presents the history of the cash flow statement by its first trace in the second half of the 19th century. The analysis by Paolone is focused on the annual reports by some large US and British companies. Paolone presents Scholars' investigations on the cash flow statement and its history using several first works on the topic (Cole, 1908; Finney, 1923; Greene, 1897). In this perspective, the cash flow statement is regarded as a "*widespread document although there were few companies that published it regularly*" (p. 34).

The chapter titled "The Value Relevance of Accounting Information and Cash Flows: A Review of Prior Studies and Models" represent one of the most relevant contributions of the book by Paolone. The chapter is devoted to defining the concept of value relevance in the context of accounting information and its quality in providing results to stakeholders. First of all, Paolone assumes the value relevance "*as a tool for measuring the significance, quality, and reliability of economic and financial information*" (p.

37) even if its definition is widely proposed by literature since 1960. Starting from the joint investigation of the market value and financial statement value, Paolone shows several fields of analysis in capital market research (for instance, Ball and Brown, 1968). The value relevance is related to the market efficiency and transparency as proposed by the Author. Additionally, Paolone discusses the price and return models to evaluate the value relevance: "*1. Price models, which investigate the existence of a potential relationship between stock prices and one or more balance sheet values; and 2. Return models, which test the existence of a potential relationship between returns (or stock price changes) and one or more values contained in the financial statements*" (p. 41). Lastly, the value relevance framework is shown through the meaning of the valuation, value relevance, clean surplus and decision usefulness theories. An overview of the value relevance is proposed by Paolone through the cash flows.

The chapter titled "Data Analysis on EU and US Listed Companies" presents a research analysis based on empirical evidence aimed at demonstrating the value relevance of OCF, posing the following question "*What about the importance of cash flow from the investors' perspective, specifically, the reflection of Operating Cash Flow (OCF) information content on a company's market value?*" (p. 53). Paolone discusses OCF defining it as the corporate ability to originate cash flows "*from the operating activities and for this reason, it can be used as a proxy, and thus, it reflects the market value. However, cash flows from investing and financing activities are a function of OCF because the OCF level will determine the need for external financing and future investment*" (p. 53) and following its influence on the market price of companies. Thus, an empirical analysis on the largest European companies (i.e. top 500 listed companies) and US-listed companies (i.e. top 500 listed companies) is proposed by Paolone (in the chapter) through a clear and original sampling process as well as a model specification and variables. Paolone aims to provide a comparison of the book value of equity recognizing the value relevance. Interestingly, OCF confirms its connection to the market price and the relevance of its informative content confirming its value relevance. Additionally, Paolone presents several research considerations among which "*when financial statements are broken down into accruals and cash components, there is a greater value relevance perceived by the investors. The value relevance of the reported losses is lower than that of profits. However, the value relevance of "OCF" that is not reported in the income statement or the balance sheet cannot be negligible when it is assessed in the context of the entire database of active firms* *at year-end*" (p. 64). Thus, OCF confirms its potential value relevance compared to the earnings and book value in the analysis by Paolone.

The last chapter of this book review is titled "Concluding Remarks: The Importance of Cash Flow Statement". The final contribution of this book is widely focused on the relevant role of the cash flow statement. Paolone also highlights the cash flow analysis in the context of corporate disclosure and to overcome the static representation of value, to predict and measure insolvency and to adopt business evaluation.

However, the last part of the chapter by Paolone proposes an innovative contribution based on the integrated report view to overcoming some limits by the previous analysis on the value relevance and cash flow statement. In this perspective, the disclosure of non-financial information (by the European Directive 2014/95/EU and Legislative Decree no. 254/2016) introduces a way to report information not provided through the financial statements. Even if Paolone underlines that integrated reports are not replacing financial statements, companies adopt several standards (e.g. Global Reporting Initiative, International Integrated Reporting, Framework of the International Integrated Reporting Council) to compose non-financial reports integrating relevant information not provided in the mandatory (financial) annual reports.

In conclusion, the book by Paolone presents an original analysis focused on the intersection of accounting information, value relevance and cash flow, proposing evidence to support the identification and determination of the value relevance. Thus, the contribution of the book by Paolone expands the existing literature, confirming the potential of the value relevance in the cash flow statements and proposing an alternative to overcome some limitations by the financial analysis and disclosure (Behn et al., 2019). In this way, mixing financial and non-financial perspectives in the accounting environment represents the challenge welcomed by companies to determine, measure and disclose value and information to stakeholders (e.g. investors and analysts). However, the pathway is open and requires both the understanding of standards, frameworks and forthcoming regulations (e.g. Corporate Sustainability Reporting Directive) for its development towards the harmonization process (Cordazzo et al., 2020; Lombardi, 2021) and further investigations to discover the intersection of value relevance, financial and non-financial information.

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