Restrictions on Financial Statements and Their impact on Investment Decisions

"A case study of Khartoum Stock Market"

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Abstract

The resrearchfocused on therestrictions on financial statements and their impact on investment decisions, in the Khartoum Stock Market. The research aimed at answering the following question:Does the limitation of financial statements affect on investment decisions?. The resrearch found that the limitations of financial statements have a significant negative impact on the investment decisions. The resrearch recommended that Theaccounting profession all over the globe need to adopt the international accounting standards' to fit the users of financial statements needs.

Keywords: financial statements, balance sheet, income statement, cash flows, investment decisions.

1- Introduction:

The primary limitation of financial statements is its heavy reliance on historical costs, indifference to inflation, prone to frauds, easily manipulated, etc. Financial statement limitations are relatable with current markets looking at the accounting and financial fraud in the news every day[1].

In the present digital world the companies use financial statements as one of the major medium ofcommunication with their stakeholders. Individual investment behavior is concerned with choicesabout purchases of small amounts of securities for his or her own account. Investment decisions areoften supported by different decision tools. It is believed that information structure and the factors inthe market systematically influence individualinvestment decisions as well as market outcomes. Therefore,stock market regulators and accounting standards setters are trying to improve the quality offinancial statements in order to increase the transparency level in financial reporting (Savita Pandey, et all: 2016, p11)[2].

1.1- Statement of the Problem:

The study focused to investigate that Is financial statements reliable when making a decision on investing in such a company?

1.2- Hypothesis of the Study:

The study tests the hypothesis that the limitations of financial statements have a significant negative impact on the investment decisions.

1.3- Objective of the study:

The study aims to highlight the concept of financial statements and its importance in enhancing the investment decisions.

2- Literature Review:

The consequences of earnings management relate to the decisions takenby investors, managers, directors, and regulators. Of great interest isthe research area that addresses how earnings management affectscapital investment decisions. There is also an emerging literature whichexplores the role of financial statement information in investmentdecisions. These lines of thinking leads toexamine whether intentional distortions in accounting numbers affectinvestment decisions and whether earnings manipulation drives firmsto make suboptimal investment decisions. The studyaims to provide new evidence on whether motivated by compensation targets or capital market expectations, accounting misstatements distort the investment decision making process of the firms by incorporatingthe manipulated accounting numbers, which means “misreporting toinvestors results in resource misallocation”.The studyask whether decision making process is distorted since earningsmanagement ends up with manipulated information incorporatedin the internal financial reporting and internal decision makingprocess and suggest that earnings management significantly affects firms’ investment decisions. Relating the economic consequences of earnings management and resource allocation, they contributeto the literature suggesting that earnings management can lead toinefficient investments which is a direct cost to investors. This studyalso contributes to the literature identifying that earnings managementaffects decision making within firms and not only investment decisionsmade by outside investors based on financial reports. Firms duringoverstated earnings periods tend to overinvest in property, plant, andequipment or in general fixed assets, which means that there is animpact and change on internal decision making process of investors‘expectations of the firm’s fundamentals, but also the fundamentalshave been changed too,(Konstantinos&Georgia: 2017, p2)[3].

2.1- The Concept of financial statement:

Financial statements normally include a balance sheet, a statement of income, a statement of changes in equity and a statement of cash flows.

Notes to financial statements are an integral part of such statements(Larry, 2013).

Financial Statements may consist different type of information which can be named as Financial Information/Accounting Information and Non Financial Information/Non Accounting Information. AccountingInformation are information which describes an account for a utility. It processes financial transactionsto provide external reporting to outside parties such as to stockholders, investors, creditors, andgovernment agencies and non accounting information are information which cannot be measured inmonetary terms to make investment decisions by the investors. Though the investors use non financialinformation in order to make investment decisions, still conventional investors give more weight tofinancial information(Pandey, et all: 2016, p11).

Financial statements, also called financial reports, refer to such statements as containing financial information of an enterprise. Thus, these statements are collection of data presented strictly according to logical and consistent accounting principles. They are overall general purpose entity statements as they report financial position and operating results of an entire business at the end of the accounting period.

The financial statements are the end products of financial accounting, which contain summarized periodical reports of the financial and operating data accumulated by the firm in its books of accounts, known as the General Ledger. As a matter of fact, these statements reflect the totals of the summary of the books of account(Manisha tanwar).

By brief, the financial statements (financial reports),reflect a true picture about the profits and losses,financial position,and the financial performancesof an enterpriseat the end of the accounting period. That financial statements basically should include the following reports:

- Balance sheet.
- Profit and Loss statement.
- Cash flow statement.
- Statement of changes in equity.

2.2- limitations of financial statements:

The limitations of financial statements are those factors that a user should be aware of before relying on them to an excessive extent. Knowledge of these factors could result in a reduction of invested funds in a

business, or actions taken to investigate further. The following are all limitations of financial statements[2]:
- Dependence on historical costs. Transactions are initially recorded at their cost. This is a concern when reviewing the balance sheet, where the values of assets and liabilities may change over time. Some items, such as marketable securities, are altered to match changes in their market values, but other items, such as fixed assets, do not change. Thus, the balance sheet could be misleading if a large part of the amount presented is based on historical costs.
- Inflationary effects. If the inflation rate is relatively high, the amounts associated with assets and liabilities in the balance sheet will appear inordinately low, since they are not being adjusted for inflation. This mostly applies to long-term assets.
- Intangible assets not recorded. Many intangible assets are not recorded as assets. Instead, any expenditures made to create an intangible asset are immediately charged to expense. This policy can drastically underestimate the value of a business, especially one that has spent a large amount to build up a brand image or to develop new products. It is a particular problem for startup companies that have created intellectual property, but which have so far generated minimal sales.
- Based on specific time period. A user of financial statements can gain an incorrect view of the financial results or cash flows of a business by only looking at one reporting period. Any one period may vary from the normal operating results of a business, perhaps due to a sudden spike in sales or seasonality effects. It is better to view a large number of consecutive financial statements to gain a better view of ongoing results.
- Not always comparable across companies. If a user wants to compare the results of different companies, their financial statements are not always comparable, because the entities use different accounting practices. These issues can be located by examining the disclosures that accompany the financial statements.
- Subject to fraud. The management team of a company may deliberately skew the results presented. This situation can arise when there is undue pressure to report excellent results, such as when a bonus plan calls for payouts only if the reported sales level increases. One might suspect the

presence of this issue when the reported results spike to a level exceeding the industry norm.

- No discussion of non-financial issues. The financial statements do not address non-financial issues, such as the environmental attentiveness of a company's operations, or how well it works with the local community. A business reporting excellent financial results might be a failure in these other areas.

- Not verified. If the financial statements have not been audited, this means that no one has examined the accounting policies, practices, and controls of the issuer to ensure that it has created an accurate financial statements. An audit opinion that accompanies the financial statements is evidence of such a review.

- No predictive value. The information in a set of financial statements provides information about either historical results or the financial status of a business as of a specific date. The statements do not necessarily provide any value in predicting what will happen in the future. For example, a business could report excellent results in one month, and no sales at all in the next month, because a contract on which it was relying has ended.

3- Investment Decisions concept:

The Investment Decision relates to the decision made by the investors or the top level management with respect to the amount of funds to be deployed in the investment opportunities.Simply, selecting the type of assets in which the funds will be invested by the firm is termed as the investment decision(businessjargons.com).

(FAO)refer to,"Capital budgeting is vital in marketing decisions. Decisions on investment, which take time to mature, have to be based on the returns which that investment will make. Unless the project is for social reasons only, if the investment is unprofitable in the long run, it is unwise to invest in it now"(FAO. Org).

The financial-dictionarydefinedInvestment Decisions as "Determination of where, when, how, and how much capital to spend and/or debt to acquire in the pursuit of making a profit", Factors contributing to an investment decision include, but are not limited to: capital on hand, projects or opportunities available, general market conditions, and a specific investment strategy(The financial-dictionary).

4- Research Methodology

Inductive and deductive approach was used and the methodology of the case study. The questionnaire was adopted as a tool for collecting data to elicit the respondents' perception of the The limitations of financial statements have a significant negative impact on the investment decisions.The researcher designed the questionnaire to collect explicable data about the restrictions on financial statements and their impact on investment decisions.

4.1- Distribution of Respondents:

Out of the 60 questionnaires administered 54 were selected for final analysis.

4.2- Distributions by Respondents Category:

4.2.1- Distribution Respondents by age Category:

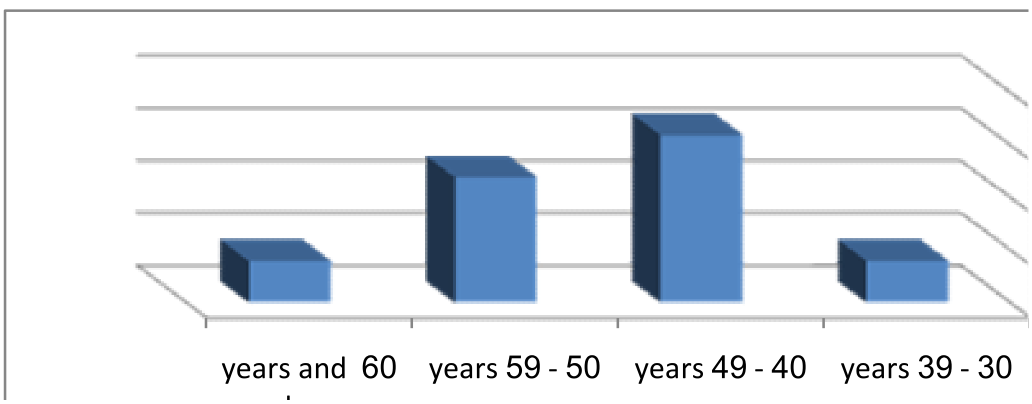
Table 4-1 shows the distribution Respondents by age Category. Their age distribution shows that 4 (11,1%) of the respondents between 30 - 39 years, 16 (44,4 %) between 40 - 49 years, 12 (33,4 %) between 50 - 59 years, while 4 (11,1%) were 60 years and above. This indicates that the majority of the respondents were between the age of 40 – 59 years old.

Table 4-1Distribution Respondents by age Category

age		
Category	**Frequency**	**Percentage**
Below 30 years	-	-
30 - 39 years	4	11.1%
40 - 49 years	16	44.4%
50 - 59 years	12	33.4%
60 years and above	4	11.1%
total	**36**	**100%**

Source: Field Survey, 2019.

Figure 4.1:Distribution Respondents by age Category



Source: Field Survey, 2019.

4.2.2- Distribution Respondents by qualification Category:

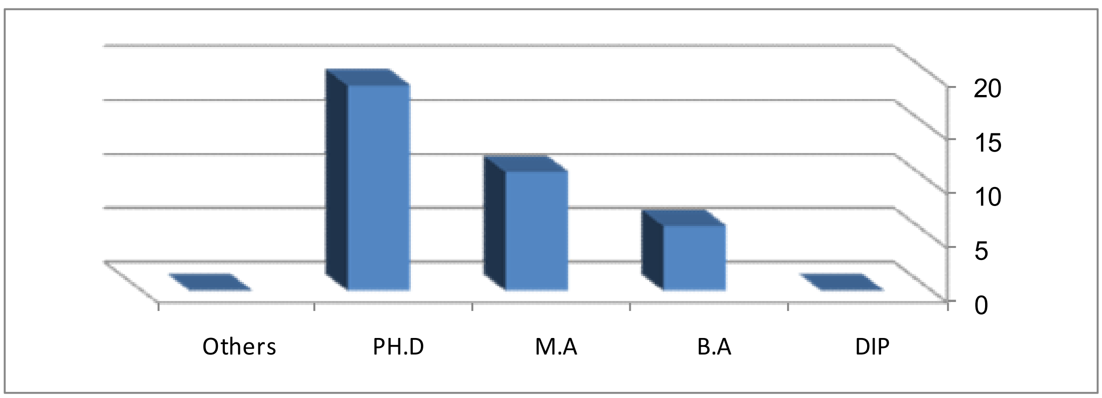
Table 4-2 shows the distribution Respondents by qualification Category. The distribution of respondents by educational qualifications indicates that 6 (16,6%) had B.A, 11 (30,6%) had M.A, 19 (52.8%) had PH.D. This indicates that the majority of the respondents had PH.D digree.

Table 4-2 Distribution Respondents by qualification Category

Education		
Category	Frequency	Percentage
DIP	0	0
B.A	6	16.6%
M.A	11	30.6%
PH.D	19	52.8%
Others	0	0
total	36	100%

Source: Field Survey, 2019.

Figure 4-2 Distribution Respondents by qualification Category



Source: Field Survey, 2019

4.2.3- Distribution Respondents by majors Category:

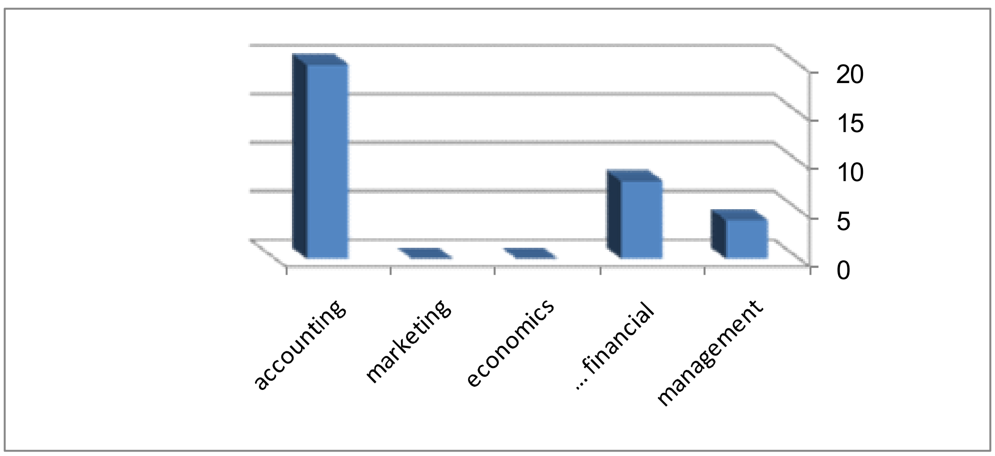
Table 4-3 shows the distribution Respondents by majors Category. The table shows that 4 (11,1%) were management, 8 (22,2%) were financial management, 20(55,6%) were accounting, while 4 (11.1%) were other major. This indicates that the majority of the respondents were accounting majors Category.

Table 4-3: Distribution Respondents by majors Category

Majors		
Category	Frequency	Percentage
Management	4	11.1%
Financial management	8	22.2%
Economics	0	0
Marketing	0	0
Accounting	20	55.6%
Others	4	11.1%
Total	36	100%

Source: Field Survey, 2019

Figure 4-3 Distribution Respondents by majors Category



Source: Field Survey, 2019

4.2.4- Distribution Respondents by jobs Category:

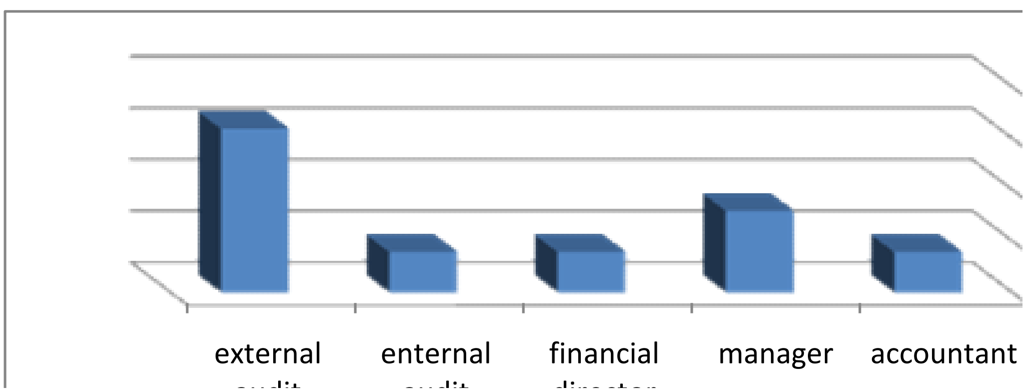
Table 4-4 shows the distribution Respondents by jobs Category. The table shows that 4 (11,1%) were accountant, 8 (22,2%) were manager, 4 (11,1%) were financial director, 16 (44,4%) were Internal audit, while 4 (11,1%) were external audit. This indicates that the majority of the respondents were accountant.

Table 4-4: Distribution Respondents by jobs Category

Jobs		
Category	Frequency	Percentage
Accountant	4	11.1%
Manager	8	22.2%
Financial director	4	11.1%
Internal audit	16	44.4%
External audit	4	11.1%
Total	36	100%

Source: Field Survey, 2019.

Figure 4-4 Distribution Respondents by jobs Category



Source: Field Survey, 2019.

4.2.5- Distribution Respondents by Experience Category:

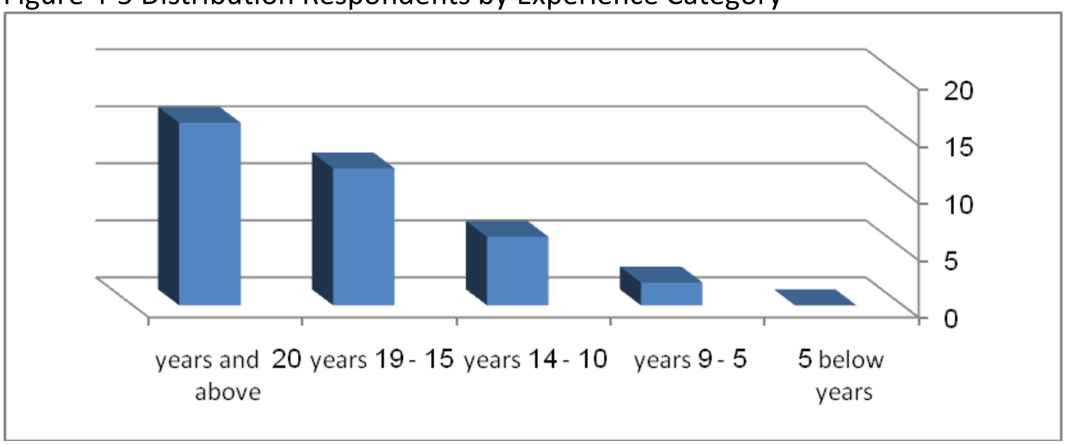
Table 4-5 shows the distribution Respondents by experience Category. Their experience distribution shows that 2 (5,6%) of the respondents between 5 - 9 years, 6 (16,6 %) between 10 - 14 years, 12 (33,4%) between 15 - 19 years, while 16 (44,4%) were 20 years and above. This indicates that the majority of the respondents were 20 years and above.

Table 4-5: Distribution Respondents by Experience Category

Experience Category	Frequency	Percentage
Below 5 years	0	0
5 - 9 years	2	5.6%
10 - 14 years	6	16.6%
15 - 19 years	12	33.4%
20 years and above	16	44.4%
Total	36	100%

Source: Field Survey, 2019.

Figure 4-5 Distribution Respondents by Experience Category



Source: Field Survey, 2019.

4.3- Measurement of Variable:

The hypothesis for this study is operationalized using Correlation Coefficient:

That the limitations of financial statements have a significant negative impact on the investment decisions.

Table 4-6 shows the Respondents' opinions about Confidence in the financial statements have a significant and positive impact on the investment decisions. Their Respondents' opinions show that 32 (88.9%) of the respondents agreed, 4 (11,1%) disagree. This indicates that the majority of the respondents agreed thatConfidence in the financial statements have a significant and positive impact on the investment decisions.

Table 4-6: Respondents' opinions about:

Confidence in the financial statements have a significant and positive impact on the investment decisions

	Frequency	**Percentage**
Agree	32	88.9%
Neutral	-	0
Disagree	4	11.1%
Total	36	100%

Source: Field Survey, 2019.

Table 4-7 shows the Respondents' opinions about There is a relationship between The limitations of financial statements and Dependence on historical costs. Their Respondents' opinions show that all of the respondents agreed,This indicates that all of the respondents agreed thatthere is a relationship between The limitations of financial statements and Dependence on historical costs.

Table 4-7: Respondents' opinions about:

There is a relationship between The limitations of financial statements and Dependence on historic**al costs**

	Frequency	**Percentage**
Agree	36	100%
Neutral	0	0
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-8 shows the Respondents' opinions about Transactions are initially recorded at their cost, where the values of assets and liabilities may change over time. Their Respondents' opinions show that 28 (77.8%)

of the respondents agreed, 8 (22,2%)of the respondents were neutral. This indicates that the majority of the respondents agreed that Transactions are initially recorded at their cost, where the values of assets and liabilities may change over time.

Table 4-8: Respondents' opinions about:

Transactions are initially recorded at their cost, where the values of assets and liabilities may change over time

	Frequency	**Percentage**
Agree	28	77.8%
Neutral	8	22.2%
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-9 shows the Respondents' opinions about the balance sheet could be misleading if a large part of the amount presented is based on historical costs. Their Respondents' opinions show that 28 (77.8%) of the respondents agreed, 8 (22,2%)of the respondents were neutral. This indicates that the majority of the respondents agreed thatthe balance sheet could be misleading if a large part of the amount presented is based on historical costs.

Table 4-9: Respondents' opinions about:

The balance sheet could be misleading if a large part of the amount presented is based on historical costs.

	Frequency	**Percentage**
Agree	28	77.8%
Neutral	8	22.2%
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-10 shows the Respondents' opinions about the limitations of financial statements are those factors that a user should be aware of before relying on them to make investment decisions. Their Respondents' opinions show that 20 (55,6%) of the respondents agreed, 16 (44,4%) of the respondents were neutral. This indicates that no dealt aboutthe limitations of financial statements are those factors that a user should be aware of before relying on them to make investment decisions.

Table 4-10: Respondents' opinions about:

The limitations of financial statements are those factors that a user should be aware of before relying on them to make investment decisions

	Frequency	Percentage
Agree	20	55.6%
Neutral	16	44.4%
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-11 shows the Respondents' opinions about Knowledge of the limitations of financial statements could result in a reduction of investing funds in a business. Their Respondents' opinions show that 30 (83,3%) of the respondents agreed, 6 (16,7%) of the respondents were neutral. This indicates that the majority of the respondents confirmed that the Knowledge of the limitations of financial statements could result in a reduction of invested funds in a business.

Table 4-11: Respondents' opinions about:
Knowledge of the limitations of financial statements could result in a reduction of investing funds in a business

	Frequency	Percentage
Agree	30	83.3%
Neutral	6	16.7%
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-12 shows the Respondents' opinions about By cases of inflation, the amounts of assets and liabilities in the balance sheet will appear inordinately low, that have a negative impact on the investment decisions. Their Respondents' opinions show that 26 (72,2%) of the respondents agreed, 6 (16,7%) of the respondents were neutral,4 (11,1%) of the respondents disagreed. This indicates that the majority of the respondents agreed that by cases of inflation, the amounts of assets and liabilities in the balance sheet will appear inordinately low, that have a negative impact on the investment decisions.

Table 4-12: Respondents' opinions about:
By cases of inflation, the amounts of assets and liabilities in the balance sheet will appear inordinately low, that have a negative impact on the investment decisions.

	Frequency	Percentage
Agree	26	72.2%
Neutral	6	16.7%
Disagree	4	11.1%

Total	36	100%

Source: Field Survey, 2019.

Table 4-13 shows the Respondents' opinions about the accounting policies can drastically underestimate the value of a business, a user should be aware of before relying on. Their Respondents' opinions show that 24 (66,6%) of the respondents agreed, 6 (16,7%) of the respondents were neutral, 6(16,7%) of the respondents disagreed. This indicates that the majority of the respondents agreed that The accounting policies can drastically underestimate the value of a business, a user should be aware of before relying on.

Table 4-13: Respondents' opinions about:

The accounting policies can drastically underestimate the value of a business, a user should be aware of before relying on.

	Frequency	**Percentage**
Agree	24	66.6%
Neutral	6	16.7%
Disagree	6	16.7%
Total	36	100%

Source: Field Survey, 2019.

Table 4-14 shows the Respondents' opinions about the decision maker can gain an incorrect view of the financial results or cash flows of a businessby only looking at one reporting period. Their Respondents' opinions show that 24 (66,6%) of the respondents agreed, 8 (22,2%) of the respondents were neutral, While 4(11,1%) of the respondents disagreed. This indicates that the majority of the respondents agreed that The decision maker can gain an incorrect view of the financial results or cash flows of a businessby only looking at one reporting period.

Table 4-14: Respondents' opinions about:

The decision maker can gain an incorrect view of the financial results or cash flows of a businessby only looking at one reporting period.

	Frequency	**Percentage**
Agree	24	66.6%
Neutral	8	22.2%
Disagree	4	11.1%
Total	36	100%

Source: Field Survey, 2019.

Table 4-15 shows the Respondents' opinions about The financial statements are not always comparable, because the entities use different accounting practices. These issues can effect on the decisions investment.

Their Respondents' opinions show that 32 (88,9%) of the respondents agreed, 4(11,1%) of the respondents were neutral. This indicates that the majority of the respondents agreed that The financial statements are not always comparable, because the entities use different accounting practices. These issues can effect on the decisions investment.

Table 4-15: Respondents' opinions about:

The financial statements are not always comparable, because the entities use different accounting practices. These issues can effect on the decisions investment.

	Frequency	**Percentage**
Agree	32	88.9%
Neutral	4	11.1%
Disagree	0	0
Total	36	100%

Source: Field Survey, 2019.

Table 4-16 shows the Respondents' opinions about the management of a company may deliberately skew the results of the financial statements. Their Respondents' opinions show that 32 (88,9%) of the respondents agreed, 3 (8,3%) of the respondentswereneutral, while 1(5,6%) of the respondents disagreed. This indicates that the majority of the respondents agreed that the management of a company may deliberately skew the results of the financial statements.

Table 4-16: Respondents' opinions about:

The management of a company may deliberately skew the results of the financial statements.

	Frequency	**Percentage**
Agree	32	88.9%
Neutral	3	8.3%
Disagree	1	2.8%
Total	36	100%

Source: Field Survey, 2019.

Table 4-17 shows the Respondents' opinions about the results of the financial statements are considered unfair, If the financial statements have not been audited. Their Respondents' opinions show that 31 (86,1%) of the respondents agreed, 4 (11,1%) of the respondents were neutral, while 1(5,6%) of the respondents disagreed. This indicates that the majority of the respondents agreed that the results of the financial statements are considered unfair, If the financial statements have not been audited.

Table 4-17: Respondents' opinions about:

The results of the financial statements are considered unfair, If the financial statements have not been audited

	Frequency	Percentage
Agree	31	86.1%
Neutral	4	11.1%
Disagree	1	2.8%
Total	36	100%

Source: Field Survey, 2019.

Table 4-18 shows the Respondents' opinions about the statements do not provide any value in predicting what will happen in the future, because The information of financial statements relying on historical results. Their Respondents' opinions show that 27 (75%) of the respondents agreed, 7 (19,4%) of the respondentswere neutral, while 2(5,6%) of the respondents disagreed. This indicates that the majority of the respondents agreed that the statements do not provide any value in predicting what will happen in the future, because The information of financial statements relying on historical results.

Table 4-18: Respondents' opinions about:

The statements do not provide any value in predicting what will happen in the future, because The information of financial

	Frequency	Percentage
Agree	27	75%
Neutral	7	19.4%
Disagree	2	5.6%
Total	36	100%

Source: Field Survey, 2019.

The results presented in table 3-6 to table 3-15 indicate that "The limitations of financial statements have a significant negative impact on the investment decisions".

Conclusion:

After the studying of theoretical and practical sides of Restrictions on financial statements and their impact on investment decisions, the following results are obtained:

The study has shown that the limitations of financial statements have a significant negative impact on the investment decisions.

The study revealed that the majority of respondents (77,8%) were between the age of 40 – 59 years old, and a majority (52.8%) had PH.D degree, The majority (55.6%) were an accountant, The majority (44.4%) were 20 years and above.

The study revealed that majority 88,9% confirmed that Confidence in the financial statements has a significant and positive impact on the investment decisions.All of the respondents agreed that there is a relationship between The limitations of financial statements and Dependence on historical costs. It was also revealed 77,8% that transactions are initially recorded at their cost, where the values of assets and liabilities may change over time.

The study also shows that no dealt about the limitations of financial statements are those factors that a user should be aware of before relying on them to make investment decisions.

The most important recommendations:

The accounting profession all over the globe need to adopt the international accounting standards' to fit the users of financial statements needs.

The companies should the necessity to issue the annual financial statements with their details and without any deletions.

Identifying the factors that limit the of financial statements use on investment decisions.

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