Restrictions on financial statements and their impact on investment decisions
"A case study of Khartoum Stock Market"

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Abstract

This research investigated the impact of limitations in financial statements on investment decisions within the Khartoum Stock Market. The central question explored was: Do limitations in financial statements influence investment decisions? The study concluded that these limitations have a significant negative effect on investment decisions. The research recommends the global adoption of International Accounting Standards to better meet the needs of financial statement users.

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

1- Introduction:

Financial statements suffer from several key limitations, including a strong reliance on historical costs, a failure to adequately account for inflation, susceptibility to fraud, and potential for manipulation. These limitations are particularly relevant in today's markets, given the frequent reports of accounting and financial fraud [1].

In today's digital age, financial statements serve as a crucial communication tool between companies and their stakeholders. Individual investors, concerned with personal investment choices, often rely on various decision-making tools. Both individual investment decisions and overall market outcomes are significantly influenced by information availability and market factors. Consequently, stock market regulators and accounting standard setters are continually striving to enhance the quality of financial statements to promote greater transparency in financial reporting (Savita Pandey, et all: 2016, p11)[2].

1.1- Statement of the Problem:

The study investigated whether financial statements are reliable for making investment decisions in a company.

1.2- Hypothesis of the Study:

This study tests the hypothesis that limitations in financial statements significantly and negatively affect investment decisions.

1.3- Objective of the study:

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

2- Literature Review:

Earnings management has consequences for investors, managers, directors, and regulators. A key area of research explores how earnings management influences capital investment decisions. A growing body of literature also examines the role of financial statement information in investment decisions. These lines of inquiry lead to the question of whether intentional distortions in accounting figures affect investment decisions, and specifically, whether earnings manipulation leads to suboptimal investment choices. This study aims to provide further evidence on whether accounting misstatements, driven by compensation targets or capital market expectations, distort firms' investment decision-making processes. Essentially, the study investigates whether "misreporting to investors results in resource misallocation" by incorporating manipulated accounting numbers”. This study investigates whether earnings management, by introducing manipulated information into internal financial reporting and decision-making, distorts the decision-making process. It proposes that earnings management significantly impacts firms' investment decisions. Connecting the economic consequences of earnings management with resource allocation, this research supports existing literature suggesting that earnings management can result in inefficient investments, representing a direct cost to investors. This study further contributes to the literature by demonstrating that earnings management affects internal decision-making within firms, not just external investment decisions based on published financial reports. Firms experiencing periods of overstated earnings tend to overinvest in property, plant, and equipment (or fixed assets in general). This indicates an impact not only on investors' expectations of a firm's fundamentals, but also a change in the fundamentals themselves, due to the altered internal decision-making process, (Konstantinos & Georgia: 2017, p2)[3].

2.1- The Concept of financial statement:

Standard financial statements consist of a balance sheet, income statement, statement of changes in equity, and statement of cash flows, all accompanied by integral explanatory notes(Larry, 2013).

Financial statements contain both financial (accounting) and non-financial (non-accounting) information. Financial information, derived from processing financial transactions, provides quantifiable data for external reporting to stakeholders such as stockholders, investors, creditors, and government agencies. This data is expressed in monetary terms. Non-financial information, while relevant to investment decisions, cannot be directly measured in monetary terms. Examples include market share, customer satisfaction, or management quality. Although investors consider non-financial factors, conventional investment analysis typically places greater emphasis on financial data. (Pandey, et all: 2016, p11).

Financial statements, or financial reports, provide a comprehensive overview of an enterprise's financial information. These statements are structured collections of data, prepared in strict adherence to consistent and logical accounting principles. As general-purpose reports, they present the overall financial position and operating results of a business at the end of an accounting period.

Financial statements are the final output of financial accounting, summarizing periodic financial and operational data from a company's general ledger. Essentially, these statements represent the aggregated totals of the company's accounting records (Manisha tanwar).

By brief, inancial statements (or reports) provide a clear overview of an enterprise's profitability, financial position, and performance at the end of an accounting period. These statements typically include:

- Balance sheet
- Income statement (or Profit and Loss statement)
- Cash flow statement
- Statement of changes in equity"

2.2- limitations of financial statements:

Financial statements have limitations that users should understand before relying on them heavily. Recognizing these limitations can help investors mitigate risks and prompt further investigation. Key limitations include: [2]:

- **Reliance on Historical Costs:** Financial statements initially record transactions at their historical cost. This can be misleading, particularly on the balance sheet, where asset and liability values may fluctuate over time. While some items, like marketable securities, are adjusted to reflect current market values, others, such as fixed assets, remain at their historical cost. Consequently, a balance sheet heavily reliant on historical costs may not accurately represent the current financial position

- **Inflationary Effects:** During periods of high inflation, the historical cost basis of assets and liabilities on the balance sheet can significantly understate their true value. This is particularly relevant for long-term assets, as their reported values may not reflect the erosion of purchasing power.

- **Exclusion of Intangible Assets:** A significant limitation is the frequent exclusion of intangible assets from financial statements. Expenditures related to creating these assets, such as brand development or research and development, are often immediately expensed rather than capitalized. This practice can substantially undervalue businesses, particularly those with strong brand recognition or innovative products. This is especially problematic for startups that have invested heavily in intellectual property but have yet to generate significant revenue.

- **Time-Period Specificity:** Relying solely on a single reporting period can provide a misleading view of a business's financial performance or cash flows. Isolated periods may be affected by temporary fluctuations, such as sudden sales spikes or seasonal variations, which deviate from normal operating results. To obtain a more accurate understanding of long-term trends, it's essential to analyze multiple consecutive financial statements.

- **Limited Comparability:** Financial statements from different companies may not be directly comparable due to variations in accounting practices. To address this, users should carefully review the accompanying disclosures, which reveal the specific accounting methods employed by each entity.

- **Susceptibility to Fraud:** Management may intentionally manipulate financial results, particularly under pressure to achieve specific targets. For example, bonus plans tied to sales growth can incentivize misrepresentation. Suspiciously high results, significantly exceeding industry benchmarks, may indicate potential fraud.

- **Exclusion of Non-Financial Factors:** Financial statements solely focus on monetary data, neglecting crucial non-financial aspects. This includes factors like environmental impact, social responsibility, and community engagement. Consequently, a company with strong financial performance may still exhibit significant shortcomings in these areas.

- **Lack of Verification:** Unaudited financial statements lack independent verification, meaning no external party has assessed the issuer's accounting policies, practices, and controls for accuracy. An auditor's opinion, accompanying audited financial statements, provides evidence of such a review.

- **Limited Predictive Value:** Financial statements primarily offer historical or current financial information. They do not reliably predict future performance. For instance, a company may report strong results in one period, followed by a dramatic decline due to unforeseen events, such as the termination of a key contract.

In essence, financial statements provide valuable information, but users must be aware of these limitations to make informed decisions

3- Investment Decisions concept:

An investment decision involves the strategic allocation of funds to various investment opportunities, undertaken by investors or top-level management. In essence, it is the process of selecting the specific types of assets in which a firm will invest its capital (businessjargons.com). An investment decision, often referred to as a capital budgeting decision, is the process of allocating financial resources to various assets or projects with the [1] expectation of generating future returns, (https://unstop.com/).

The Food and Agriculture Organization (FAO) emphasizes the critical role of capital budgeting in marketing strategies. Investment decisions, characterized by their long-term maturation, must be grounded in the anticipated future returns.

Unless a project's primary objective is social impact, investing in ventures projected to be unprofitable in the long term is imprudent "(FAO. Org).

The financial-dictionary defined Investment Decisions as " Investment decisions encompass the determination of where, when, and how much capital to allocate, including the potential acquisition of debt, with the primary objective of generating profit. Key factors influencing these decisions include, but are not limited to: available capital, viable investment opportunities, prevailing market conditions, and a defined investment strategy (The financial-dictionary).

4- Research Methodology:

This research employed both inductive and deductive reasoning within a case study framework. Data was collected using a questionnaire designed to assess respondents' perceptions regarding the impact of financial statement limitations on investment decisions. The questionnaire aimed to gather comprehensive data on the specific restrictions inherent in financial statements and their subsequent influence on investment choicesrestrictions 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:

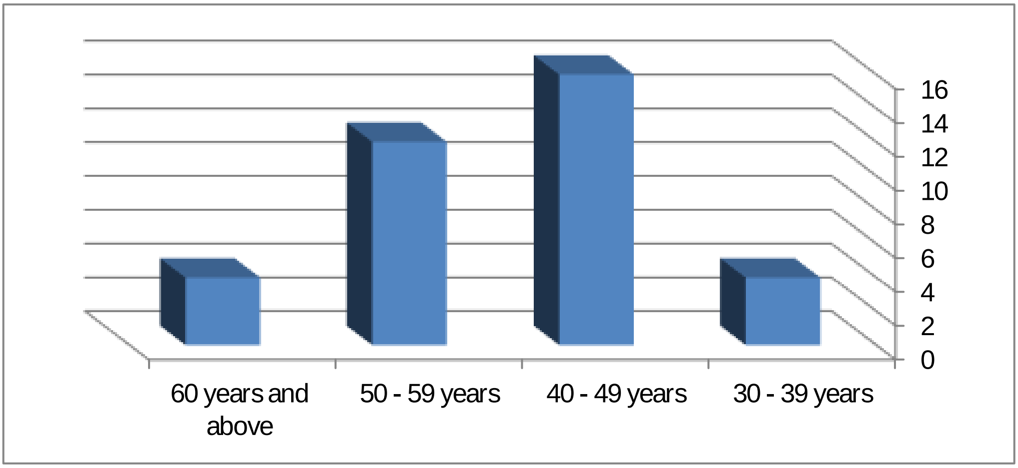
Table 4-1 shows the distribution Respondents by age Category. Their age distribution shows that 4 (11,1%) of the respondents between 30 - 39 years, 16 (44,4 %) between 40 - 49 years, 12 (33,4 %) between 50 - 59 years, while 4 (11,1%) were 60 years and above. This indicates that the majority of the respondents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

<u>Table 4-1 Distribution Respondents by age Category</u>

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.

Figure 4.1: Distribution Respondents by age Category



Source: Field Survey.

4.2.2- Distribution Respondents by qualification Category:

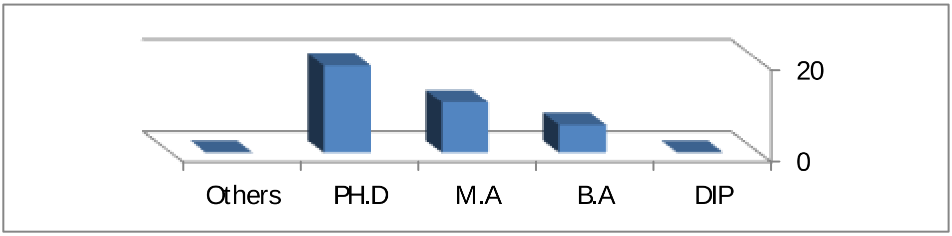
Table 4-2 shows the distribution Respondents by qualification Category. The distribution of respondents by educational qualifications indicates that 6 (16,6%) had B.A, 11 (30,6%) had M.A, 19 (52.8%) had PH.D. This indicates that the majority of the respondents had PH.D digree.

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.

Figure 4-2 Distribution Respondents by qualification Category



Source: Field Survey

4.2.3- Distribution Respondents by majors Category:

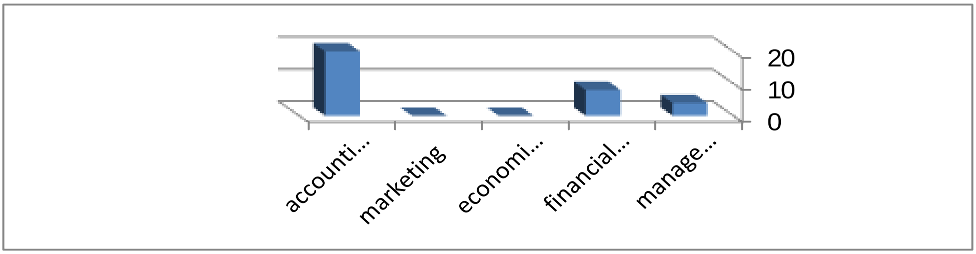
Table 4-3 shows the distribution Respondents by majors Category. The table shows that 4 (11,1%) were management, 8 (22,2%) were financial management, 20(55,6%) were accounting, while 4 (11.1%) were other major. This indicates that the majority of the respondents were accounting majors Category.

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

Figure 4-3 Distribution Respondents by majors Category



Source: Field Survey

4.2.4- Distribution Respondents by jobs Category:

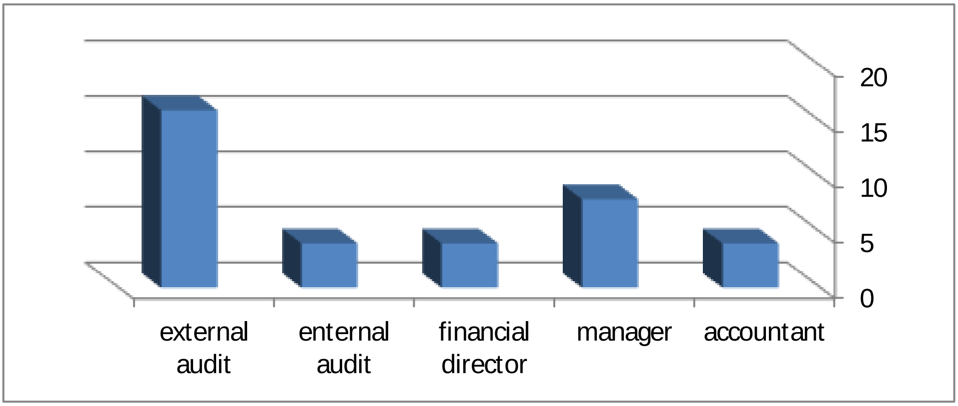
Table 4-4 shows the distribution Respondents by jobs Category. The table shows that 4 (11,1%) were accountant, 8 (22,2%) were manager, 4 (11,1%) were financial director, 16 (44,4%) were Internal audit, while 4 (11,1%) were external audit. This indicates that the majority of the respondents were accountant.

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.

Figure 4-4 Distribution Respondents by jobs Category



Source: Field Survey.

4.2.5- Distribution Respondents by Experience Category:

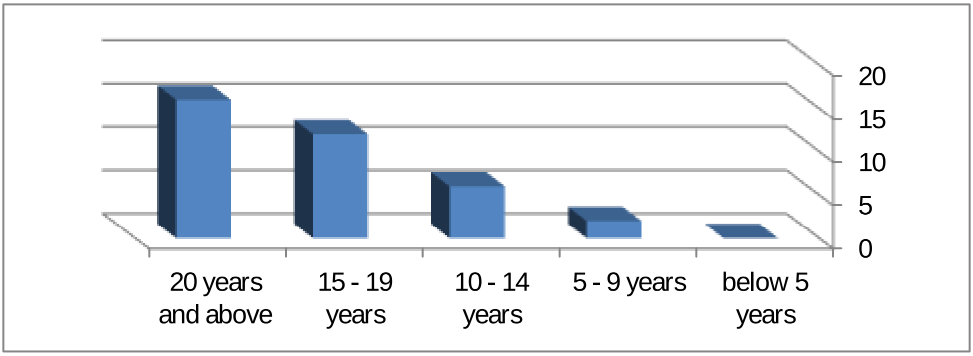
Table 4-5 shows the distribution Respondents by experience Category. Their experience distribution shows that 2 (5,6%) of the respondents between 5 - 9 years, 6 (16,6 %) between 10 - 14 years, 12 (33,4%) between 15 - 19 years, while 16 (44,4%) were 20 years and above. This indicates that the majority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

Figure 4-5 Distribution Respondents by Experience Category



Source: Field Survey.

4.3- Measurement of Variable:

- **Hypothesis:** This study posits, operationalized through correlation coefficient analysis, that the limitations of financial statements exert a significant negative influence on investment decisions.
- **Respondent Opinions (Table 4-6):**
  - The questionnaire also assessed respondents' views on the impact of confidence in financial statements on investment decisions.
  - Results indicate that a substantial majority, 32 respondents (88.9%), agreed that confidence in financial statements has a significant positive impact on investment decisions.
  - Conversely, 4 respondents (11.1%) disagreed.
- **Interpretation:** These findings strongly suggest that the respondents generally believe that confidence in financial

statements is a crucial factor in making sound 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.

Table 4-7 shows All respondents (100%) agreed that there is a relationship between the limitations of financial statements and the reliance on historical costs.

This indicates a strong perceived correlation between the general limitations of financial statements and the specific issue of dependence on historical costs.

Essentially, the respondents overwhelmingly recognize that the use of historical costs is a significant limitation of financial statements.

Table 4-7: Respondents' opinions about:
There is a relationship between The limitations of financial statements and Dependence on historical costs

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

Source: Field Survey.

Table 4-8 Findings:

Majority Agreement: A significant majority of respondents, 28 out of 36 (77.8%), agreed that transactions are initially recorded at cost, even though asset and liability values may change over time.

Neutral Response: 8 respondents (22.2%) expressed a neutral opinion.

Indication: This demonstrates that most respondents acknowledge and understand the financial statement limitation of relying on historical cost.

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.

Table 4-9 Findings:

Majority Agreement: 28 out of 36 respondents (77.8%) agreed that a balance sheet can be misleading when heavily reliant on historical costs.

Neutral Response: 8 respondents (22.2%) remained neutral.

Conclusion: The majority of respondents acknowledge the potential for balance sheets to be misleading due to the reliance on historical cost accounting.

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.

Table 4-10 Findings:

- **Majority Agreement:** 20 out of 36 respondents (55.6%) agreed that users should be aware of financial statement limitations before making investment decisions.
- **Significant Neutral Response:** 16 respondents (44.4%) were neutral.
- **Interpretation:** While a majority agreed, the substantial neutral response suggests that there may be some ambiguity or differing opinions among respondents regarding the extent to which users need to be aware of these limitations. The original sentence said "no dealt" which is not proper english, and also does not match the data. A majority of respondents did agree.

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.

Table 4-11 Findings:

- **Strong Agreement:** A significant majority of respondents, 30 out of 36 (83.3%), agreed that knowledge of financial statement limitations could lead to a reduction in invested funds.
- **Neutral Response:** 6 respondents (16.7%) remained neutral.
- **Conclusion:** This indicates a strong consensus among respondents that awareness of financial statement limitations influences investment decisions by potentially causing a decrease in investment.

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.

Table 4-12 Findings:

- **Majority Agreement:** A substantial majority of respondents, 26 out of 36 (72.2%), agreed that inflation causes asset and liability values on the balance sheet to appear artificially low, negatively impacting investment decisions.
- **Neutral Response:** 6 respondents (16.7%) remained neutral.
- **Minority Disagreement:** 4 respondents (11.1%) disagreed.
- **Conclusion:** This indicates a clear consensus among respondents that inflation's impact on balance sheet values is a recognized limitation of financial statements and can negatively affect 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.

Table 4-13 Findings:

- **Majority Agreement:** 24 out of 36 respondents (66.6%) agreed that accounting policies can significantly undervalue a business and that users should be aware of this limitation.
- **Neutral Response:** 6 respondents (16.7%) remained neutral.

- **Minority Disagreement:** 6 respondents (16.7%) disagreed.
- **Conclusion:** The majority of respondents acknowledge that accounting policies, especially those related to intangible assets and historical costs, can lead to substantial undervaluation of businesses, and therefore should be considered by those making investment decisions.

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.

Table 4-14 Findings:

- **Majority Agreement:** 24 out of 36 respondents (66.6%) agreed that relying on a single reporting period can lead to an inaccurate understanding of a business's financial performance.
- **Neutral Response:** 8 respondents (22.2%) were neutral.
- **Minority Disagreement:** 4 respondents (11.1%) disagreed.
- **Conclusion:** The majority of respondents acknowledge that analyzing financial data from a single period can be misleading for decision-makers.

Table 4-14: Respondents' opinions about:

The decision maker can gain an incorrect view of the financial results or cash flows of a business by 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.

Table 4-15 Findings:

- **Strong Agreement:** A very high majority of respondents, 32 out of 36 (88.9%), agreed that the lack of comparability between financial statements due to differing accounting practices impacts investment decisions.
- **Neutral Response:** 4 respondents (11.1%) were neutral.
- **Conclusion:** This demonstrates a strong consensus among respondents that the variability in accounting practices across companies is a significant limitation affecting the usefulness of financial statements for investment decisions.

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.

Table 4-16 Findings:

- **Strong Agreement:** A very high majority of respondents, 32 out of 36 (88.9%), agreed that company management may intentionally manipulate financial statement results.
- **Neutral Response:** 3 respondents (8.3%) were neutral.
- **Minority Disagreement:** 1 respondent (2.8%) disagreed.
- **Conclusion:** This strongly indicates that respondents are highly aware of and concerned about the potential for management to engage in fraudulent financial reporting.

It is important to notice that the code provided by you, returns slightly different results than the numbers provided in the prompt. The provided prompt has the correct percentages.

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.

Table 4-17 Findings:

- **Strong Agreement:** A very high majority of respondents, 31 out of 36 (86.1%), agreed that unaudited financial statements are considered unreliable.
- **Neutral Response:** 4 respondents (11.1%) were neutral.
- **Minority Disagreement:** 1 respondent (2.8%) disagreed.

- **Conclusion:** This indicates a strong consensus among respondents that an audit is crucial for establishing the credibility and fairness of financial statements.

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.

Table 4-18 Findings:

- **Majority Agreement:** A substantial majority of respondents, 27 out of 36 (75%), agreed that financial statements have limited predictive value due to their reliance on historical data.
- **Neutral Response:** 7 respondents (19.4%) were neutral.
- **Minority Disagreement:** 2 respondents (5.6%) disagreed.
- **Conclusion:** This demonstrates a clear understanding among respondents that financial statements are primarily retrospective and not reliable for forecasting future performance.

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.

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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