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Financial Reporting, Framing Effects and Successful Investment Decision

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Abstract
The purpose of this study is to determine the relationship of the financial reports and investment decision and framing bias affects the relationship of financial reporting and investment decision. We collected data through 225questionnaires from individual investors of Islamabad stock exchange (ISE). Result shows that financial reporting is significantly positive associated with investment decision and framing bias affects the relationship of financial reporting and successful investment decision. Our study may help the investor to focus on present facts and choices as neutrally and consistently at the time of investment decision and to keep the big picture in mind.

1. Introduction

A financial statement is an official record of the financial actions of a business. Firm's all the significant financial data, accessible in an organized way and in a form easy to understand is called the financial statement. For large firms these statements are regularly multifaceted and may contain a wide set of "NOTES" to the financial statements and description of financial strategies and management argument. They normally comprise of four basic financial statements named Income Statement, Balance Sheet, Statement of Cash Flows and Statement of Changes in Equity.

The objective of financial reporting is to transmit the financial and non-financial information to the lenders and shareowners (the stakeholders) of the business. Because investors and lenders have the right to know about their money. According to Financial Accounting Standard Board (FASB) and International Accounting Standard Board (IASB) (1999, 2008) the major objective of financial reporting is to be responsible for high-quality financial reporting information about trade and industry individuals, mostly financial in nature, convenient for economic decision making. Financial reporting quality could shrink the information asymmetry between the firm and the investors and as a result lesser firm's cost of monitoring managers and successful project selection.

Financial statements may be used by users for different purposes. Lasher (2008) said that "If accounting is the language of finance then financial reporting is the communication of financial information useful for making investment, credit, and other business decisions". Like, prospective investors make use of financial statements to measure the sustainability of investing in a particular business. Investors commonly use financial analysis which are set by specialists (financial analysts) and make investment decision on the basis of those analyses.

Firms usually assume that the users of the financial statements are properly well-informed about business and finance and normally understand the basic accounting terms and measurement methods. But in actuality each normal investor not understands the accounting terms; few investors who have knowledge can understand the terms which is used in financial statements. McDaniel, Martin and Maines (2002) found that only the financial experts understand the qualitative features of accounting information in financial reporting which was promoted by the FASB's Statement of Financial Accounting Concepts (SFAC) No.2.

Firms do not fully disclose their private information leaving some information asymmetry between the firm and outside investors. For example firms normally do not release all the information they have about individual transactions but rather disclose aggregate information in the arrangement of financial statements. The firms provide financial statements under Generally Accepted Accounting Principles (GAAP), but reporting discretion and investors are not perfectly aligned because managers have confidential facts about the firm's performance which is not captured by its financial reporting system (Stocken & Verrecchia, 2004). The conflict arises when managers apply different nature of framing at the time of disclosure of accounting information in the financial statements. Framing is a cognitive experience in which investor make financial decisions based on the 'framework' within which a situation was offered. According to Shefrin (2000) "framing is the human tendency to take a decision based on the circumstances which they were represented under". When investor biased with framing than investment decision may be depends on the opacity of the frame. The positive values could be followed by the negative values because some time presentation of data decides not the fundamental information (Shefrin, 2000), i-e presenting results as gains lean towards to convince risk-aversive selections and presenting results as losses lean towards to convince risk-seeking selections.

Investment decision play vital role because this decision relate with the future profit. Individuals, firms and governments all are frequently in the situation of determining whether or not to invest and in what way to select among the opportunities available. In modern ages different opportunities of getting financial information have become presented to investors but investors focus simply on inadequate past accounting information which is accessible in the financial statements to know about the economic conditions of the firm's operations and often make incorrect investment decisions because each investor take different perception fromsame information which is differently presented in the financial statements.

The objective of our study is test that how normal investors examine publically presented financial statements at the time of investment decision and how much financial statements align with investors for making right investment decision. We also test that information which is shown in financial statements is presented differently and that information effects the investment decision.

Our study may help the investor to focus on present facts and choices as neutrally and consistently at the time of investment decision and to keep the big picture in mind (long-term financial goals).Through this study investor framing bias could be reduced and he/she will be able to make factual investment decision.

2. Literature Review

A financial statement is an official record of the financial actions of a business. The major objective of financial reporting is to be responsible for high-quality financial reporting information about trade and industry individuals, mostly financial in nature, convenient for economic decision making (FASB, 1999; IASB, 2008). Quality means, financial reports comprises of financial and non-financial information which is useful for economic decision making. Generally Accepted Accounting Principles (GAAP), is the set of guidelines, provide the origin in the arrangement of financial statements. Financial Reporting Review Panel (FRRP) in U.K and Australia's security regulator, ASIC, both bodies are recognized to contribute to comparable international execution through their experience as national administration bodies and their participation in regional and international mediums (Brown& Tarca, 2007). Accordingly Stocken and Verrecchia, (2004) that the firms provide financial reports under generally accepted accounting principles (GAAP), but reporting discretion and investors are not perfectly aligned because managers have confidential facts about the firm's performance which is not captured by its financial reporting system. Beside this some firms may use the complicated financial terms (language) in their Financial reporting to misguide the investors, for the purpose of investor's convenient in October 1998, the U.S. Securities and Exchange Commission (SEC) promoted "plain English" publish rules, and claim that firms could use ambiguous language with the aim of hide contrary information, and regular investors may not be able to understand multifaceted financial reports.

Spathis (2002) found that at the time of investment decision the most investors examine the publically presented financial statements and take their investment decisions on the basis of historical data like as Total Assets, Inventories, Working Capital, Equity, Sales and Net Profits presented in these financial statements. But Diacon and Hasseldine (2007) found that historical investment performance is normally not beneficial to retail investors in terms of its capability to forecast future profits but know about the risk perception. They also studied that the presentation of historical performance graphs has a substantial effect on fund selection and risk sensitivities. Mostly investors make biased investment decisions even on the basis of falsified financial statements because information is limited and that limited information may be used by the managers to create a frame in the minds of investors. Framing is a cognitive experience in which investor make financial decisions based on the 'framework' within which a situation was offered.

According to Chong and Druckman (2007) Framing refers to the process by which people develop a particular conceptualization of an issue or reorient their thinking about an issue. Managers may generally apply different nature of framing at the time of disclosure of accounting information in the financial statements like as risky choice framing, attribute framing and goal framing.

Gibbins, Richardson and Waterhouse (1990) investigate that the financial confession in financial reporting are subjective by several interior organizational factors, such as the firm's history, its financial performance, the personality and preferences of its CEO, its size and the degree of internal agreements. For example, a change in CEO may bring a swift change in disclosure strategy.

Spathis (2002) found that at the time of investment decision the most investors examine the publically presented financial statements. The finance managers may succeeded to create some particular frame in the minds of investors when the investors use the financial reports as a base of investment decision, as the Susan T. Fiske and Shelley E. Taylor (1984) found that human beings are by nature have a preference to do as little thinking as possible. Individuals make perceptions through natural and cultural outcomes and at the time of selections they make influenced by their making of a frame. Framing may encourage choice discrepancies and cause of inconsistent behavior. The framing manner is a significant factor of investors' stock investment decisions and narrow framing would have comprehensive effect on investors' portfolio choices and tradeoff choices away from its effect on risk outlooks (Kumar & Lim, 2008).

In Asian countries framing consequence is bidirectional both for gain and losses i.e. presenting results as gains incline towards to convince risk-aversive selections and presenting results as losses lean towards to convince risk-seeking selections. Decision maker's frame of mind influence uncertain selections by including with situational influences, specifically the decision frames of gain or loss (Seo, Goldfarb & Barrett, 2010).

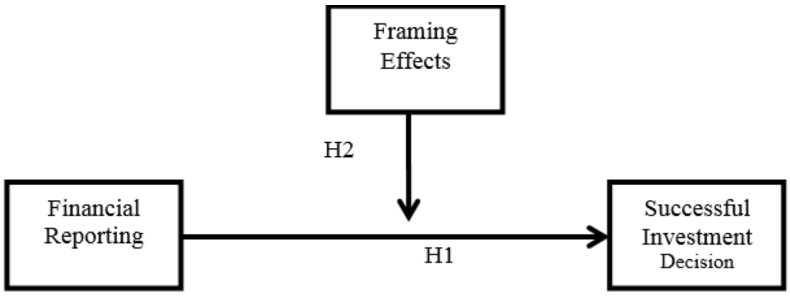
When investors associate the dependence of preferences on frames, they make wrong decisions because investor might have different preferences in a different framing of the same problem and investor is uninformed of other frames and of their possible effects on the relative desirability of options. As the Kuhberger, Mecklenbeck and Perner (1999) investigate that the characterization of the framing occurrence as a "perceptive artifice" is misrepresentative. A predictive direction inspires the investor to emphasis on future involvement and to question "what will I feel than?" rather than "what do I want now?" and also suggest that the predictive principle of judiciousness can be realistic to resolve unpredictable preferences and to improve the value of choices.

2.1. Hypothesis

H1: Financial reports effects the investment decision

H2: Framing effects plays a moderator role between the relationship of financial reporting and investment Decision

Schematic Diagram of Theoretical Framework



3. Research Methodology

The purpose of current study is hypothesis testing and type of investigation used is causal study. There are three variables in the study which are financial reporting, the successful investment decision and the framing effects. The framing effect captures the psychological and behavioral aspect of investors this has been taken as a Moderating variable to measure the framing effects. We have used the questionnaires developed by Harsh and Shefran after converting these into lekert scale 4, while the independent variable is financial reports that are the periodic financial information that companies provide to general public, to measure the financial reports we have used the questionnaires used by Beest, Braam & Boelens (2009) and our dependent variable is successful investment decision and to measure this variable we used the questionnaires from a working paper.

Primary data was collected through the questionnaires from the individual investors of Islamabad (Pakistan). 225 questionnaires were floated from which 162 were gets response, from these 162 some papers were with missing information and finally the useable responses were 150. We used SPSS 20 to run the Regression and Correlation tests.

4. Data Analysis

Table 1: Model Summary

Modal	R	R^2
1	59.6%	35.5%
2	59.6%	35.5%

a. Predictors: (Constant), FRM.EFC, FIN.REP

b. Predictors: (Constant), FRM.EFC, FIN.REP, FINxFRM

As shows in Table-1 R^2 value is 35.5 % which indicate that financial reporting has 35.5% explanatory power of our Independent variable for the successful investment decision and remaining can be explained by some other factors which can contribute towards the successful investment decision. We have checked the combine relationship (financial reporting and framing effect) on the investment decision; results are same and indicate that moderator variable (framing effects) does not affect the financial reporting.

The ANOVA result as shows in Table 2 that the overall linear regression model is significant with F value 40.419 But linear regression model is less significant with combine effect of predictor and moderator variable; F value is 26.771.

Table 2: ANOVA

Modal	F	Sig
1 Regression	40.419	0.000[a]
2 Regression	26.771	0.000[b]

a. Predictors: (Constant), FRM.EFC, FIN.REP
b. Predictors: (Constant), FRM.EFC, FIN.REP, FINxFRM

In table 3 modal 1 shows the coefficient analysis without moderator variable (framing effect), where T value is 3.804, and the rules suggest that if the value is > 1.96, results are significant. Our value is as previously mention is 3.804 which show a high level of significance. Modal 2 in table 3 shows the result with the effect of moderator variable, where T value is 1.188 which is less than 1.96 (1.188 <1.96) and indicate that moderator variable (framing effect) is not significant.

Table 3: Coefficients

Modal	T	Sig
1 Regression	3.804	0.000
2 Regression	1.188	0.237

a. Dependent Variable: INV.DIS

H1: Financial Reports effects the investment decision is accepted as the Table 4 shows the SPSS results of Correlation between financial reporting and investment decision is .578**, which shows the strong Correlation between them.

H2: Framing bias affects the financial reporting is accepted as the Table 4 shows the positive correlation between financial reporting and framing effect as the figures 0.186*. Results are clearly supporting our hypothesis, after then we have checked the relationship of framing effect with the investment decision, it also shows a strong relationship supporting the figure of .250**.

The male respondents were 112 (74.7%) and the female respondents were 38 (25.3%).

Table 4: Correlations

	Financial Reporting	Investment Decision	Framing Effect
Financial Reporting	1	.578**	.186*
Investment Decision	.578**	1	.250**
Framing Effect	.186*	.250**	1

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

5. Discussion

It is common practice in financial decision world that the investors at the time of investment decision rely on the financial reports presented by the company into their annual reports and in other statutory reports. These reports are considered important for decision making as stated by Lasher (2008) "If accounting is the language of finance then financial reporting is the communication of financial information useful for making investment, credit, and other business decisions". One reason of using these statements may be that the investor take them as a reliable and authentic source of information as these are prepared by great care as claimed by companies beside this these reports get audited by professional bodies (Charted Accountancy Firms) and SECP govern all the matters related to their correctness and reliability as it is investigated that International Accounting Standard Board (IASB) (1999, 2008) the major objective of financial reporting is to be responsible for high-quality financial reporting information about trade and industry individuals, mostly financial in nature, convenient for economic decision making. The investors can use the financial reports for the financial analysis of the companies to check the trends of financial performance over the several last years to predict the next direction of the companies. Financial report includes several notes to data which provide detailed information related to the matters which can't be covered in Balance sheets (Butt, 2012). There can also be other several reasons to base the investment decision on financial reports depending upon the preferences and for several mental justifications. All of them can force an investor to rely on financial reports at the time of investment decision. This also has been proven by our results that there is highly positive correlation between the investment decision and financial reports as shown in Table 4. Results of our study are consistent with the findings of Spathis (2002) who in his research investigated that at the time of investment decision the most investors examine the publically presented financial statements and take their investment decisions on the basis of historical data like as Total Assets, Inventories, Working Capital, Equity, Sales and Net Profits presented in these financial statements.

All of the previous research has attempted to capture the impact of financial reporting on investment decision, or some researcher has checked the relationship of framing effect on investment decision. But none of the researcher has tried to check the framing as a moderator between the financial reporting and investment decision. We have focused our research to find the moderating effect of framing on financial reporting and investment decision. When we talk about the behavioral aspect of investor we can see that different investors create box within in which they indulge certain type of information and they only choose information from this frame of mindthat is also explored by Chong and Druckman (2007) Framing refers to the process by which people develop a particular conceptualization of an issue or reorient their thinking about an issue. Some companies want to present the financial reports to attract the investors as stated by Diacon and Hasseldine (2007) the presentation of historical performance graphs has a substantial effect on fund selection and risk sensitivities, but this information is taken by different type of investors differently and these reports creates the different type of frames that effects the relationship between the financial reports and investment decision. This also has proven by our results which shows the positive correlation of moderator on the relationship between financial reporting and investment decision as shown in table 4 the regression where T value is 7.592, and the rules suggest that if the value is > 1.96 than the impact will be significant.

6. Conclusion

This paper examine whether the investors rely on the financial reports at the time of investment decision. Our results indicate the positive significant relationship between financial reporting and successful investment decisions. Our results also show that framing bias affects the relationship of financial reporting and successful investment decision. Finally we find that investors focus on the limited information as stated by Susan T. Fiske and Shelley E. Taylor (1984) that human beings are by nature have a preference to do as little thinking as possible and use the information which can be easily obtained and use it a basis of investment decision.

7. Implication

At the time of investment decision the most investors examine the publically presented financial statements (Spathis, 2002). The finance managers may succeed to create some particular frame in the minds of investors when the investors use the financial reports as a base of investment decision. Our study may help the investor to focus on present facts and choices as neutrally and consistently at the time of investment decision and to keep the big picture in mind (long-term financial goals). Through this study investor framing bias could be reduced and he/she can make successful investment decision.

8. Limitations and Future Research Direction

Our study illustrates that this research is not fully definite due to short time spam. Our sample size is only 200 for analysis. For future research we can enhance the sample size to generalize its results. This research focus on the investor framing bias only, in future the work can be done to test the other basis that can affect investment decisions of not only the individual investors but also of fund manager's investment decisions.

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Appendix

Questionnaire
"Financial Reporting, Framing Effects and Investment Decision"

Purpose of Study: **Academic**

Gender: _____ **Age**: 1. 18-25 2. 26-33 3. 34-41 4. Above 41

Never	Seldom	Often	Always
1	2	3	4

		N	S	O	A
Q. 1	How frequently did you usually use financial reports in decisions for the investment in stock?				
Q. 2	How frequently did you usually use financial statements in the selling and buying decision of existing stock?				
Q. 3	How frequently did you usually participate in decisions to delete existent stock?				
Q. 4	The figures (absolute amounts) given in balance sheet are enough for analysis of stock's worth at the time of investment decision?				
Q. 5	The notes to the balance sheet and the income statement sufficiently clear?				
Q. 6	Would you understand these financial reports helpful to you for predicting the stock's expected return.				
Q. 7	The financial statement conditions effects your investment decision				
Q. 8	The stock market liquidity Position effect the investment decision				
Q. 9	Are the expected corporate earnings affect your investment decision				
Q. 10	How much your investment decision affected by data presentation in financial statements				

Suppose you have the opportunity to invest your savings, there are two funds available to invest,

Q. 11 One is ABC Mutual Fund which will give u return between -4% to 16%, would you decide to invest in ABC Mutual Fund

Q. 12 The other is XYZ Mutual Fund Which will give u return between -14% to 26%, would you decide to invest in XYZ Mutual Fund

Q. 13 Suppose after retirement you need Rs. 50,000/month to live comfortable life OR Rs. 40,000 for basic needs OR minimum of Rs. 30,000 to sustain. Further assume that there is no inflation. Which investment opportunity you will choose?

Investment 1. Rs. 40,000/month, offering you a chance of risk free life style

Investment 2. 50% chance of Receiving Rs. 50,000 and a 50% chance of receiving Rs. 30,000/month

Q. 14 Now suppose after retirement you need Rs. 50,000/month to live comfortable life OR Rs. 40,000 for basic needs OR minimum of Rs. 30,000 to sustain. Further assume that there is no inflation. Which investment opportunity you will choose?

Investment 1. Gives you a comfortable life with the probability of 50% and 50% probability of only to sustain

Investment 2. Gives you a life only with basic needs but not ensure the comfortable life.