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Harnessing Financial Information in Investors Decissions: Accrual Accounting versus Cash Accounting

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Abstract

This study aims to analyze the influence of the value added of the information developed according on the two main accounting systems for investment decision making, with direct impact on the market capitalization of the listed companies. To obtain the research results, in the study were analyzed specific financial information, collected for a sample of 65 Romanian listed companies on the Bucharest Stock Exchange, between 2011 and 2013. For data analysis were used econometric models from the literature, based on the multiple regression analysis and adapted to the research objectives. At the level of the study, there was estimated and tested the influence of the information attained based on the use of cash accounting (quantified through the cash flow from operations, cash flow from investing and cash flow from financing) and based on the use of accrual accounting (quantified through the variation of the operating and net income) on the capital gains yield of listed companies. Research results show a growth of the value relevance of the information obtained based on the use of accrual accounting compared to the ones obtained as a result of cash accounting use, in the case of Romanian listed companies.

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Keywords: financial information, investors, accrual accounting, cash accounting, value relevance;

1. Introduction

Financial markets' volatility generates intense concerns to investors regarding the permanent improvement of the efficiency in the decision-making process related to the placement of available capitals. To substantiate their decisions, investors should use financial information that meet quality criteria, in the analysis of the determinants

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influence on the returns on invested capital. Financial statements published by economic entities provide a significant informational support, which is complementary to economic environmental factors and contribute to limiting uncertainty associated to the process of transferring capital.

Information from the annual financial statement must meet the requirement of faithful representation of financial position and performance for the reporting entity. In this sense, financial information must meet certain qualitative criteria.

Though significantly normalized, accounting still provides different perspectives on displaying the economic reality within specific structures (accrual accounting, cash accounting), thus keeping actual the debates concerning the use of informational output.

Still in its maturation process, the Romanian capital market significantly concern investors regarding the pertinence of the accessed information. In this context, the debate regarding the information relevance and the principles base on which they were elaborated confirm their utility.

The study proposes an analysis of the influence of the information resulted from the appliance of the accrual accounting principles (materialized through performance indicator – operating and net result) and information that is specific to cash accounting (synthesized through cash-flows) on the investment decisions of the available capital owners (expressed by the evolution of attained capital gains yield).

2. Relevance – Fundamental characteristic of financial information

According to IAS 1 "*Presentation of financial statements*", faithful representation requires the exact reporting of the transactions' effects, of other events and conditions, according to the definition and recognition criteria for assets, liabilities, revenues and expenditures established through the General Framework (IASB, 2011). The Romanian accounting regulation, represented by the OMFP 1802/2014 also require that useful financial information must be relevant and to present faithfulness financial positions and performance. From this perspective, it's notice a harmonization of the qualitative characteristics provided by the actual international accounting regulation and the Romanian accounting standards (RAS).

IASB expertise claims that useful financial information meets two basic qualitative characteristics: *relevance* and *faithful representation* of economic reality. *Relevant* financial information is the one that can provide support for the stakeholders in decision making process (OMFP 1802/2014). We appreciate that financial information is relevant if it has predictive value, confirmation value or both values. Financial information has a *predictive value* if it can be used as input in the processes applied by users to foresee future results. The *confirmation value* consists of the capacity of information to help the stakeholders to confirm or to modify previous evaluations.

In certain situations, some *type of mismatch might appear between relevance and credibility*. Thus, if there is an exaggerated delay in information presentation, its credibility can be lost. On the other hand, if the reporting of financial information is delayed, until the moment when all issues are known, its credibility cannot be challenged, but the utility is reduced for the stakeholders that had had to make decisions during that period. "Ensuring the balance between relevance and credibility requires the permanent following of the general objective: the adequate satisfaction of the users' needs in the economic decision making process." (Toma, 2011).

Annual financial statements describe the economic phenomena in words and numbers. To be a *faithful representation*, financial statements must be *complete*, *neutral* and must *lack errors*. IASB itself admits that perfection is rarely reached or even never, in spite of the fact that the main objective is to maximize these characteristics of financial information, to the extent to which it is possible (Toma, 2012).

According to the Conceptual Framework of IASB and to the RAS, alongside the fundamental qualitative characteristics, *relevance* and *faithful representation*, financial information can also meet a series of enhancing qualitative characteristics, so that to increase their utility in the decision making process. Enhancing qualitative characteristics are: comparability, verifiability, timeliness and understandability, which could support the choice of one way out of two alternatives that has to be used to describe a phenomenon, if it is considered that both are equally relevant and faithful presented.

Comparability represents the characteristic of financial information that allows time and space comparisons. In contrast to the other qualitative characteristics that aim at a single element, comparability refers to at least two elements. *Verifiability* represents the enhancing characteristic which ensures the stakeholders that the information