

Financial Performance Reporting: The Effect of Proposed Financial Statements on Investors' Operating Performance Evaluation Judgments

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Abstract

Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) (collectively, “*the Boards*”) jointly develop high quality and convergent accounting standards. Financial statement presentation project, one of the joint projects pursued by the Boards, is expected to be effective in 2011. According to the proposed financial statement presentation standard, the financial position and its related changes must be cohesively categorized into five main sections: (a) Business, (b) Discontinued Operations, (c) Income Taxes, (d) Financing, and (e) Equity (if applicable). Financial performance reporting is critical to market participants in evaluating firm operating performance and future prospects. Moreover, the statement of comprehensive income is required to be disaggregated by function and by nature. The purpose of this study is to examine the impact of the proposed format financial statements on investors' operating performance evaluation judgments. The impact of proposed changes of financial statement presentation is experimentally assessed in two experiments. Experiment 1 explores the impact of different financial statement formats with the focus in classification of the financial items, while Experiment 2 investigates the impact of the data aggregation level.

The results from Experiment 1 suggest that the proposed formats financial statements, as opposed to traditional financial statements, improve ability of the investors to evaluate operating performance of a given firm due to the fact that the operating income is presented in a separate section with prominent label. This is consistent with the Incomplete Revelation Hypothesis, which suggests that the proposed financial statements are associated with less cognitive cost to extract the operating-related information. The results from experiment 2 suggest that the by-nature information improves the investors' judgments on operating performance evaluations, which is consistent with Human Information Processing literature.