

The Effect of Financial Reporting Quality (FRQ) on Investors' Sentiments

Hamed Esmaeilnozar¹, Setareh Manavi Dadkhah² and Farzin Rezaei³

ABSTRACT

Financial reporting quality (FRQ), aimed at reducing information asymmetry between investors, is considered a key feature of accounting information. This study investigates the reduction of discretionary accruals in net profit, which serves as an indicator of higher-quality accounting information. Additionally, investors' sentiments, due to their sensitivity to varying degrees of accounting quality information, lead to different reactions in the capital market. These sentiments increase investors' risk exposure because they are difficult to control. This study aims to reduce the influence of investors' sentimental decisions driven by the publication of FRQ. To achieve this, 109 companies listed on the Tehran Stock Exchange between 2017 and 2023 were selected as a sample through a screening method. The results indicate that increasing FRQ reduces investors' positive sentimental responses. Furthermore, in companies with a higher market-to-book (MB) ratio, increasing FRQ has a negative effect on investors' sentimental responses. According to the authors, most studies on investor behavioral tendencies have focused on their effects on stock returns. However, no study has specifically examined how the quality of corporate financial statements can influence investors' emotional responses and their investment attitudes. IN order to enhance the legitimacy of governments in managing the economic system, it is recommended to establish indicators for the quality of financial reporting.

Keywords: Behavioral finance theory, Investors' sentiments, Financial reporting quality (FRQ), Asymmetric information, Representation conflict.

JEL Classification: B17, B26, D50, D53, D86, F65.

¹ M.Sc. in Accounting, Department of Accounting, Takestan Higher Education Institute, Qazvin, Iran. E-mail: Hamedesmaeilnozar@gmail.com

² M.Sc. in Accounting, Department of Accounting, Takestan Higher Education Institute, Qazvin, Iran. E-mail: Setareh.manavi@gmail.com

³ Associate Professor, Faculty Member, Department of Accounting, Qazvin Branch, Islamic Azad University, Qazvin, Iran. E-mail: Farzin.rezaei@iau.ac.ir