THE QUALITY INCREASING OF INFORMATION IN THE FINANCIAL STATEMENTS. A REARRANGEMENT OF THE QUALITATIVE CHARACTERISTICS

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Abstract

The generalized practice of using some conceptual frameworks offers a higher quality of information, by establishing specific criteria of reference.

The qualitative characteristics are those features that give utility and value to the information presented in the financial statements. They are features derived from the normalization of a conceptual framework and a chart of accounts. These qualities, which are supposed to be general for all accounting data, connect the objectives of the financial reporting and the requirements from accounting standards, by separating the useful information from the unnecessary ones, information which are going to be presented in the financial statements.

In this paper, we will conduct a research in order to find out the useful characteristics of accounting information presented in the financial statements. The research will be conducted by analyzing and comparing the information in diverse accounting framework, especially the American and the international one, both before the changes brought by the Conceptual Frameworks in 2010 and at the present time.

This analysis will not only highlight the qualitative characteristics of a useful information, but it will also present the measures undertaken by Conceptual Frameworks, international and American ones, measures that eliminate the differences of quality between characteristics, so they can be incorporated in the convergence process and increase the quality.

Keywords: fundamental qualitative characteristics, the relevance, the faithful representation, enhancing qualitative characteristics, comparability, verification, opportunity, intelligibility

JEL Classification: M40, M41

1. Introduction

Regardless of the conceptual framework they belong, the international or the American one, we observe that accounting information have many qualitative characteristics, features which before the changes from 2010 were considered compulsory by the American conceptual framework: relevance and credibility, and secondary: comparability and intelligibility. In the international framework, all four of them were considered compulsory.

The American referential, FASB, and the international one, IASB, work together to develop a common financial reporting framework.

Therefore, FASB and IASB launched the first phase of the project on 28 September 2010, as result, the International Conceptual Framework and the American issued on January 2011, regarding the “Qualitative characteristics of the information presented in the financial statements” agreed on the competency, definition, hierarchy of the qualitative characteristics, but also agreed on the restrictions necessary in order for information to be considered useful. Thus, the relevance and faithful representation are considered fundamental qualitative characteristics. Enhancing qualitative characteristics are considered the following: comparability, verification, opportunity, intelligibility, who amplifying, helps to improve the fundamental characteristics.

There are people who consider this classification arbitrary, meaning that although relevance and faithful representation are necessary, they shouldn’t be considered fundamental because they do not improve the quality information [5]. We notice that neither IASB, nor FASB use the term reliability to define accounting information, this term being replaced with the term faithful representation.

Moreover, we observe that, prudence, substance over form, verifiability which are feature of reliability, but not of the accurate representation, as they would have been redundant.

Also, the prudence and substance over form are eliminated as qualitative characteristics, being considered in the new framework as incompatible with the neutrality.

2. The fundamental qualitative characteristics

If not so long ago we considered the relevance and the credibility as core qualitative characteristics, presently
the accounting frameworks IASB and FASB tend to agree upon a common denominator, by keeping the relevance and replacing the credibility with the exact representation.

- **The information relevance** - Is the essential quality of accounting information because it refers to the ability of influencing the decisions of investors, creditors and other users of financial statements. A relevant information also helps the users to evaluate the past, present and future events and to correct eventual mistakes from the past.

  The relevance must be evaluated taking into account not only the principal objective of the financial situations, namely to help the users make decisions, but also has to consider the context in which the financial statements were elaborated. Regardless of the conceptual framework used, the relevance of information is influenced by the nature of the information and its threshold of significance.

  The nature of the information – refers to the descriptive aspect of the information (for example the re-evaluation of a new sector of activity of an enterprise, or of an tangible/intangible asset) and the threshold of significance refers to the size, value of the information (the value obtained by the new sector of activity, the value of the tangible/intangible asset).

  The two factors can together or separately ensure the relevance of information. There are cases when the nature of the information is sufficient to ensure the relevance.

  For example, the information regarding the setting up of a new sector of activity in a company is sufficient to draw attention upon the changes and the risks undertaken by the enterprise, regardless of the size of results in the new sector of activity.

  In other situations, the nature of the event must be updated with the information regarding its importance. For example, the nature of an enterprise’s equity must contain also information on size and significance of different categories of owned or borrowed capitals.

  If until the revision from 2010, the American framework presented separate the threshold of significance from the qualitative characteristics, more precisely as restriction of them for establishing the utility of information, with the new changes brought by the convergence process, the threshold of significance is presented as a feature of relevance. The conceptual frameworks consider that the relevance plays a double role in its relation with the users.

  First, has a predictive value – for example the current and even the past information regarding the level and structure of the owned capitals - which guides the investors in their forecast of the enterprise’s reaction capacity to avoid unfavorable situations.

  Second, a confirmation value - which compares the effects of decisions taken based on the forecasted financial situations, and those based on the present financial situations.

  The two values of financial information are connected. For example, the date regarding this year’s products can be used in the forecast of the next year revenues. They can also be compared with the last year(s) data. The results of this comparison help the users to correct or improve the processes which have been used to make these forecasts.

- **The faithful representation** - The conceptual frameworks consider that in order to be useful, the accounting information must represent with accuracy the respective events. The accurate representation has three features: the information must be complete, neutral and without errors.

  In the previous version of the conceptual framework, the complete and neutral features of accounting information were aspects of credibility, characteristic that is not known anymore under this name.

  However, we notice that the credibility’s features (defined in the previous conceptual frameworks), namely the accounting information mustn’t contain errors, omissions or elements which might lead to wrong interpretation – are founded in the explication given by the new version of the conceptual framework “without errors”, which completes the faithful representation.

  The conceptual framework gives supplementary explications and specifies that a representation without errors does not mean exactness under all aspects.

  For example, the case of a value’s estimation, when a value can not be determined if was exact or inexact, however an accurate representation of the respective estimation implicates that the value is describes as an estimation clearly and precisely, the nature and the limits of the estimation process are presented, the process of evaluation is considered adequate. The second feature of the accurate representation is that the information presented in the financial situations must be complete.

  We observe that in the previous version, the American conceptual framework not clearly defined this feature through SFAC2, that IASB conceptual framework, however this feature could be understood. In the new version, this drawback is eliminated though SFAC 8 Qualitative Characteristics of useful Financial Information [8].

  A complete description of the phenomenon must include all the information necessary in order for the user to understand the event. For some elements, this description must be completed with explanations regarding the significant facts on the quality and nature of the elements, factors and circumstances which might affect their quality and nature.

  For example, the complete description of a group’s assets includes a description of the group’s assets nature and a numerical description of all the group’s assets (initial cots, adjusted cost, just value).

  Nevertheless, the accurate representation of the information presented in the financial statements must be done in the reasonable limits ensured by the conceptual frameworks, limits which refers to the cost/benefit report, but also in
the limits imposed by the inaccuracy of the estimation, the professional reasoning of the specialists, the limits of the evaluation bases etc. (IASB and FASB consider the cost as the unique restriction of the financial reporting, cost which must be justified by the benefits of the reported financial information).

**The neutrality** - is another characteristic which according to the accounting conceptual framework completes the accurate representation, where that accuracy is provided when the selection and the presentation of the information from the financial statements does not influence the decisions that lead to a predetermined result.

Additionally, the information must be equally used by all categories of users, without giving advantages to some and to other being harmful.

We consider that neutrality can be conceptualized as a limitation of the tendency of presenting in a selective way the information, and not a limitation of the professional reasoning, of the possibilities of choosing diverse potential accounting methods, even if this would involve differences in the information disclosure.

The conceptual frameworks, both American and international one, highlight the fact that in order for the information presented in the financial statements to be considered useful, they need to fulfill two qualities: to be relevant and faithful represented.

### 3. The qualitative characteristics which amplifies the information

If previous versions of the conceptual frameworks of International and American had different views to present qualitative characteristics, meaning that the international referential consider the relevance, credibility (reliability), comparability, intelligence as all the main, and the American referential are distinguished by their hierarchy first two being the main and the last two secondary, currently the two conceptual frameworks have the same view: the present the hierarchy of fundamental characteristics which were described above and features which amplifiers, meaning they aimed at improving, enhancing the usefulness of relevant information and accurate representation.

In this category of secondary features, the following are included: comparability, verifiability, opportunity and intelligibility. IASB conceptual framework specifies the following advantages and limitations of using these features amplifiers [7]:

- Can be a decisive factor in determining the most appropriate choice of two alternatives to describe a phenomenon, if considered that both are equally relevant and accurately represented;
- Increases the usefulness of the information relevant and accurate represented
- The limitation of these characteristics is that either individually nor in groups can give useful information if they are irrelevant or are not represented exactly.
- The shared of the fundamental characteristics in the improvement of the fundamental characteristics is not always the same [7].
- Thus, there are situations where it is necessary that one of the characteristics to be reduced, in order to maximize another quality characteristic.
- For example, temporary reduction in comparability justifies the improvement of the relevance and the accurate representation on long-term, the requirement for appropriate presentation to partially compensate for a lack of comparability.

**Comparability** - The “static” information of the financial reporting related to a given year, most often are not relevant and do not influence the economic decisions of users, but they may be seen by comparing the same enterprises in different context; this is when its valences regarding the usefulness are achieved.

Therefore, comparability of accounting information is a necessary feature in order for it to be considered useful.

We consider that the necessity to subscribe the financial reporting to a conceptual framework, completed with international standards, is best highlighted by the characteristic comparability for accounting information.

Regardless of the conceptual framework, we noticed the same details for comparability, namely it allows users to identify and understand similarities and differences between elements. But, the comparability is not to be confused with consistency, the latter only helps to improve the comparability.

Consistency refers to using the same methods, accounting policies as far as possible without distorting the accounting information for the same elements, to ensure comparability from period to period for the same company, or for the same period but for different companies.

Also, the comparability must not be confused with the uniformity, and for ensuring the comparability of the information, similar aspects must be similarly presented, and different aspects must be differently presented.

We mentioned above that in order to ensure the comparability the same accounting procedures must be used, as possible, with the standards specifying the limits (for example, IAS 8 Accounting policies, changes in accounting estimates and errors), limits that permit the change of methods/ accounting politics when there are other pertinent methods.

Therefore, we consider that the need for comparability must not become an obstacle for the introduction of improved accounting standards. But permitting the use of alternative accounting methods to represent the same
economic phenomenon reduces the information comparability – an aspect highlighted also by the conceptual frameworks.

- **Verifiability** - If in the previous American accounting framework, the verifiability was defined as a feature of credibility, aspect which is more deducted in the international referential, both frameworks define and present this secondary characteristic the same way.

The purpose of the verifiability is to ensure the users that the information presented in the financial situations represent accurately the economic phenomenon.

These assurances are given by independent evaluators, by confirming the correspondence between the image presented and the intended purpose of events and transactions carried out.

This verification can be *done directly* (by direct observation of values, for example cash) or *indirectly* (ex, checking the entries for stocks and recalculate the closing stock using the same methods, for example, the method first in, first out).

After the measurements done by the independent evaluators, it is easy to agree on the value of liquidities, but more difficult in case of stocks and depreciable assets because of the multiple assessment methods, and much more difficult for provisions, especially those for litigation.

- **Opportunity** - Both, the current international and American conceptual framework define opportunity as a feature that enhances the usefulness of accounting information relevant and accurate representation, [7].

In previous versions of conceptual frameworks, in *the international* one the opportunity was classified as *restriction* (limit) of the qualitative characteristics with a certain balance between the need of quality, fair representation and an advantage of cost - benefits, and in *the American* was presented as a feature that *complete the relevance* of accounting information.

Regardless of its hierarchy and framing, its significance remains the same, namely that the information is available when decisions are supposed to be made. Delays in producing them may result in loss of relevance, but at the same time a fast presentation can affect its accurate representation.

The following intervals influence the opportunity: the period between the date of recognition, measurement and presentation in the financial statements and the date by which information is considered and the moment when the financial statements are published, but also the period elapsed between their publication and the use of information when decisions are make, [6].

The opportunity to present information - must be understood as a quality whose effects may not necessarily ensure relevance, or utility, but if ignored certainly limits the relevance of accounting information.

- **Intelligibility** - Another feature that can enhance the qualities of relevance and the accurate representation is *intelligibility*, whose purpose is to understand the information provided by the financial statements.

The conceptual frameworks, American and International ones believe that information should be presented as understandable as possible, classified and described in a clear and concise manner. **This feature relates the information generated by the financial statements and the user’s need for this information.**

The conceptual frameworks specify that the financial reports are prepared for those users who have sufficient knowledge on economic and business activities, although sometimes they may need the help of an expert to understand information about complex economic phenomena.

It also mentioned that in a firm complex phenomena occur that can not be converted easily in understandable phenomena, and the exclusion of information about these phenomena facilitate their understanding, but jeopardize the integrity and the accurate representation of the phenomena.

We conclude that, on the one hand we have a wide range of users who have not all the same piece of economic and accounting knowledge, and on the other hand we have financial reports, considered completed and accurately representing the events and transactions.

In this context, we consider that the information from the financial statements aren’t useful to those decision makers who do no understand them, even if the respective information describe completely and with accuracy the transactions and phenomena.

**We believe that, the intelligibility must be considered by the accounting referential as a link point between the quality of the information provided through the financial situations and the level of training and understanding of the decision makers, by sustaining a common language between those who prepare the financial statements and those who use them, and not address firstly to that category of users (investors, shareholders, creditors) who have the financial power.**

Therefore, it is important to find equilibrium though language. To support this aspect both the conceptual frameworks and the standards have a section which defines the terms. **Finding the most efficient method to define the terms, sustains the intelligibility as a characteristic of the financial situations, but also broadness their usefulness.**

- **Constraints on financial reporting** - Both IASB and FASB reached to a consensus, considering as single restriction on financial reporting the cost.

In order for information to be useful in decision making, the benefits resulting from its use should be higher than the costs generated by its production, while the assessment of benefits and costs requires a certain amount of subjectivity.
Consequently, IASB Board tries to consider the costs and benefits in relation to financial reporting in general, not only in relation to individual reporting entities, because the evaluation of the costs and benefits always justify the existence of the same reporting provisions for all enterprises.

4. Qualitative characteristics of accounting information in the Romanian referential

In the national accounting regulations - OMPF 3055/2009 for approval of accounting regulations harmonized with European directives, the usefulness of the accounting information is explained by the following features of qualitative characteristics: understandability, relevance, reliability and comparability, with all four compulsory [9].

We observe that the definitions, characteristics and limits (restrictions) related to these qualitative features are just like those international treated by IASB, but prior to its amendments, September 2010, regarding the convergence with FASB.

We believe it is time that Romanian accounting regulations also should align to the last amendments of IASB in terms of qualitative characteristics of accounting information, especially from 2012 as the international reference system (IASB conceptual framework and IAS / IFRS) becomes predominant basis for banking, insurance-reinsurance in individual financial statements.

We conclude that the conceptual framework defines and characterizes each quality of accounting information, but what is important is that it does not indicate how these features should be used.

This influences the activity of company’s management, because when they need to make a decision, they must identify every opportunity available, and then consider which option is most useful, in this way comparing the qualitative characteristics.

This analysis is a matter of professional judgment, which discusses the importance of comparing the qualitative characteristics.

In the specialized accounting literature, we find a study of an author [3] that brings into question the importance of comparing the characteristics of relevance and credibility in guiding the professional reasoning.

Even if today, the credibility is not found explicitly among qualitative characteristics, being replaced by the accurate representation, the study is still useful.

The author shows the importance given to one or other quality characteristics induce disclosure in choosing between the historical cost and fair value.

Fair value provides more relevant information than historical costs, but is not as reliable as the historical cost.

The importance given to these features is seen differently by specialists. Some of them are for credibility (exact representation) more detrimental feature relevance; others see the relevance of information more important than credibility.

In this respect, those who preparers the financial situations tend to give greater weight to a credible information, even if it is sufficiently relevant, while auditors tend to give greater importance to the relevance of information, and then to check if relevant information is also credible.

Another issue that arises concerns the practical usefulness and applicability of the requirements related to the qualitative characteristics of the accounting information.

A representative study was realized by a group of American economists [4], over a certain sample of users, trying to establish a hierarchy of the qualitative characteristics from their utility perspective, but also the impact of the qualitative characteristics over the choice of a certain accounting policy.

The study demonstrated the fact the different opinions might exist among decisions makers having in mind the two objectives.

Furthermore, the changes in the informational needs of users, determined by all the circumstances in the business environment, justify the fact that an information, with certain shared quality is considered useful at some point, and reconsidered useful when the shared quality changes [1].

5. Conclusions:

We are witnessing a rearrangement of the characteristics at conceptual level, with IASB and FASB having as objective a common base for the qualitative characteristics of the information presented in the financial statements.

Thus, they agreed on the components, definition, hierarchy of the qualitative characteristics, but also on the restrictions that must be respected in order for the characteristics to be considered useful.

We consider that the hierarchy of the fundamental characteristics is not justified, and even more, the comparability and intelligibility should not be considered secondary characteristic, especially the comparability.

The relevance of information is linked to their comparability, and also everything that IASB and FASB have done to accomplish a convergence process is connected to the comparability of information, which makes us wonder why it has not been included in the fundamental category of characteristics.
Another aspect which must be necessary mentioned refers to the fact that, even with all the changes brought to 
the qualitative characteristics in their definition, hierarchy, components, the way they must be used is not specified at 
all.

This represents an obstacle for the company’s management; especially when it has to make a decision, and 
identify all the opportunities, analyze the useful alternative, by comparing some qualitative characteristics with others, 
which might lead to a subjective evaluation.

6. References

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