

4. Qualitative Characteristics of Accounting

Having first identified that the primary objective of accounting is to provide useful information, the FASB then turned its attention to the qualities of information that serve to make it useful. SFAC No. 2 notes that useful information must have the characteristics of relevance, reliability, and comparability/ consistency:

Primary Qualities

- Relevancy -- Information should be timely and bear on the decision-making process by possessing feedback and/or predictive value.
- Reliability -- Information must be faithful in representation; free from bias, neutral, and verifiable.

Secondary Qualities

- Comparability -- Even though different companies may use different accounting methods, there is still sufficient basis for valid comparison.
- Consistency -- Deviations in measured outcomes from period to period should be the result of deviations in underlying performance (not accounting quirks).

4.1 Understandability

Perhaps the greatest challenge facing the accounting profession is to develop measurement and presentation methods that can capture and report complex business activity in a way that is understandable. Importantly, accounting reports should be comprehensible to those with a reasonable understanding of business and economic activities. It is assumed the users will study information with reasonable diligence, but it is equally presumed that those users do not need to be accounting experts. In other words, it is imperative that financial information serve the needs of individuals who may not be fully versed in the details of accountancy, but must still rely upon the reports. This is a delicate balance to strike; oversimplification may exclude valuable information while excessive detail may overload the user to the point of obscuring key issues.

Be aware of the growing complaint that accounting has become too complex. Many persons within and outside the profession protest the ever growing number of rules and their level of detail. The emerging debate is generally couched under the heading “principles versus rules.”

- Advocates of a principles-based approach argue that general concepts should guide the judgment of individual accountants. Detailed and specific rules only serve to encourage financial engineering by those who seek to have transactions fall within or outside of some specific criteria driven accounting rule.
- Others argue that the world is quite complex, and accounting must necessarily be rules-based. Reliance on individual judgment will lead to wide disparities in reports that will render meaningful comparisons impossible.

This is an interesting debate, and it is quite difficult to predict the ultimate outcome. Both points are seemingly valid and resolution will more likely be through evolution than revolution.

4.2 Threshold Issues

SFAC No. 2 makes it clear that the profession need not concern itself with immaterial items; those things that are so slight as to not influence decision outcomes. Of course, materiality is like beauty, being in the eye of the beholder. In addition, accountants admit that accounting information comes at a high cost, and nothing in accounting should be required to the extent that its cost exceeds the benefits it will produce. But, costs of accounting information are hard to measure, and weighing the benefits is even harder. So, while there is a conceptual embrace of threshold issues, these concepts are very difficult to quantify and implement.

4.3 Other Concepts

The FASB did not rest with only two concepts statements. Others have been issued on:

- Elements of financial statements -- defining and discussing the building blocks that make up financial statements (assets, liabilities, revenues, etc.)

- Recognition and measurement -- alternative approaches to measuring elements and when to recognize transactions and events
- Cash flows and present value -- proposing that the assessment of cash flow timing and probability is important in accounting outcomes
- Objectives for nonbusiness entities -- alternative financial information goals for nonbusiness entities (e.g., charities)

Each SFAC is lengthy and thought provoking. Typically, an accounting student will delve deeper into each of these in an upper level course on accounting theory and concepts.