

# [Memorandum case essay sample](https://assignbuster.com/memorandum-case-essay-sample/)

[](https://assignbuster.com/)[Economics](https://assignbuster.com/essay-subjects/economics/)

Discuss the concept of relevance. In your opinion, would the amounts reported by U. S. companies for property, plant, and equipment be more or less relevant than the current cost amounts reported by companies in England, Mexico, or elsewhere? RelevanceInformation is relevant when it influences the economic decisions of users by helping them evaluate past, present, and future or by confirming or correcting their past evaluations. Relevance is also affected by materiality. Information has the quality of relevance when it is ‘ capable of making a difference in the economic decisions of users by helping them evaluate the effect of past and present events on future net cash inflows (predictive value) or confirm or correct previous evaluations(confirmatory value), even if it is not being used’ (FASB, 2005: 2; FASB 1980: 37). In the IASB framework information has the quality of relevance ‘ when it influences the economic decisions of users by helping them evaluate past, present of future events or confirming, or correcting, their past evaluations’ (IASB, 1989: 24).

Both frameworks thus say that accounting information is relevant if it has the capacity to make a difference in a decision. The FASB requires information to be capable of making a difference in the economic decisions of users ‘ even if it is not being used’. However, to be relevant the IASB definition additionally requires that information is used i. e. influences the decision maker in making economic decisions. Another small difference between the FASB and IASB framework is the FASB framework explicitly mentions that relevant information has to have predictive and feedback value, while the IASB uses these terms implicit in its framework. ‘ The predictive and confirmatory roles of information are interrelated (IASB, 1989: 27).

First, the FASB framework defines timeliness an ancillary aspect of relevance.

Information must be available when users need it. Although timeless alone cannot make information relevant to users, a lack of timeliness may cause a loss of relevance of information reported or even make it irrelevant (FASB, 1980: 56; IASB, 1980: 43). Although the assumptions of the IASB are equal to the assumptions of the FASB, the IASB does not define timeliness as a component of relevance but as a constraint on relevant and reliable information. If the financial statement is published earlier, the relevance of the financial report increases. In the new framework timeliness is expected to be an ancillary aspect of relevance.

Second, the IASB framework defines materiality as an attribute of relevance, while in the FASB hierarchy materiality is situated as threshold for recognition. ‘ Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements’ (IASB, 1989: 30). However, the materiality criterion may not only affect the relevance of information, it may also have effect on other qualitative characteristics such as faithful representation. Consequently, materiality has to be considered as a filter to determine whether information is sufficiently significant to influence the decision of users (FASB, 2005: 3).

ReliabilityB. Discuss the concept of reliability. In your opinion, would the amounts reported by U. S. companies for property, plant, and equipment be more or less reliable than the current cost amounts reported by companies in England, Mexico or elsewhere? In the FASB framework information has the quality of reliability when this information meets the attributes representational faithfulness, verifiability and neutrality (FASB, 1980: 21). In the IASB framework, information is reliable when ‘ it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent’ (IASB, 1989: 24). The FASB and IASB frameworks thus differ fundamentally in the manner they define ‘ reliability’.

Both frameworks include faithful representation as an attribute of reliability.

Representations are faithful if there is a correspondence or agreement between the accounting measures or descriptions in the financial reports and the economic phenomena they purport to represent (FASB, 1980: 6; FASB, 2005: 3). The difference between reliability and a faithful representation is ambiguous. Since the attributes neutrality, completeness and substance of economic phenomena (substance over form) can be classified as qualities of faithful representation, reliability becomes redundant. Consequently, a point of attention is to discuss what exactly the notions reliability and faithful representation mean and what they do not mean (FASB, 2005: 2-3). In both frameworks neutrality is defined as free from bias. ‘ To that end, the common conceptual framework should not include conservatism or prudence among the desirable qualitative characteristics of accounting information. However the framework should note the continuing need to be careful in the face of uncertainty’ (FASB, 2005: 3).

In the IASB framework, prudence is defined in terms of a degree of caution. The need to be careful implies to allow a degree of caution and therefore to permit a degree of prudence, but prevent overuse of prudence. ‘ Any overuse of prudence results in a loss of transparency, which is why the ASB is right to be wary of it. When it is excessively or inconsistently applied, it can make obfuscation of results and trends possible’ (Paterson, 2002: 1). Trends in financial reporting act contrary to a faithful representation. The use of small degree of prudence as far-sighted of what can happen in the future should never be a problem. In the IASB framework, completeness explicitly was linked to reliability, while in FASB framework completeness is implicitly linked to reliability. We explained that reliability will be substituted by faithful representation.

An omission of material elements can cause information to be false or misleading and thus unreliable (IASB framework, 1989: 38). An omission can also cause a view in the financial report in which the report does not represent the transactions it purports to represent. In the new framework, completeness will be linked to the quality faithful representation. Faithful representation also includes substance over form capturing the substance of those economic phenomena and not merely their legal form (IASB, 1989: 35). In the FASB framework verifiability is used in terms of consensus among measures and that the measures have been used without error or bias. In the FASB framework verifiability is explained as a sub notion of reliability. To verify whether information is represented without error, people should check the primary documents (like an invoice) and monitor every action of the internal auditor.

The purpose of financial reporting is to be useful for a wide range of users. It’s not possible for every user to check and monitor. Where the preparer of financial statement should consider verifiability as an important attribute of faithful representation and an external auditor must check (verify) the financial report of a company as an independent party, the investors should consider verifiability as a constraint. Verifiability is therefore an important sub notion of a faithful representation, but in reality it’s impossible for every user to verify. Therefore, verifiability acts contrary to the objective of financial reporting and should be deleted as a qualitative characteristic and should be taken for granted as a constraint. The verification of the financial report is executed by the external auditor and should be seen as a given fact.

ComparabilityC. Discuss the qualitative concept of comparability. In your opinion, would the financial statements of company’s operating in one of the foreign countries listed above be comparable to a U. S. company’s financial statement. Explain.

Comparability enables users to identify and explain similarities in and differences between economic phenomena (FASB, 2005: 8). ‘ Users must be able to compare thefinancial statements of an entity through time in order to identify trends in its financialposition and performance. Users must also be able to compare the financial statements ofdifferent entities in order to evaluate their financial position, performance and changes infinancial position’ (IASB, 1989: 39). With comparability, users must be able to compare a businesses performance over time and to make comparisons with the performances of other companies. The framework also recognizes the timeliness and the benefits and costs were constraints on providing both relevant and reliable information. Information is reliable when it is free of material error and bias, and when users can depend on it to represent faithfully that which it purports to represent. Events should be accounted for and presented in accordance with their substance and economic reality, and not just their legal form.

In the FASB framework consistency – using the same accounting methods over aspan of time (FASB, 1980: 42) – is defined as a component of comparability. An increasein the level of consistency will lead to an increase in the level of comparability. TheIASB framework does not explicitly mention consistency as attribute of comparability but also suggests that consistency positively influences comparability.

In conclusion, both the FASB and IASB have defined a similar principal set of qualities of accounting information to make information provided useful to users in making economic decisions. Despite their conformity on abstract level, the attributes to give meaning to the definition of reliability differs substantially. Although both the FASB and IASB have defined understandability, relevance, reliability and comparability as qualities of accounting information that make information decision useful provided useful to users in making economic decisions, Figures 3 and 4 show that they have arrayed them in a slightly different manner. The FASB framework hierarchical structures these qualitative characteristics, while the IASB framework ranks them equally relevant.

Fair presentation is an issue. Both standard setting party bodies allow for departure from standards when their application results in misleading information. Because of this, there is a greater possibility that there will be a difference in the interpretation of fair presentation criteria.

References

– Accounting Standards Board (2005), http://www. asb. org. uk/asb/about/aims. cfm, 22-06-2005.

http://www. iasb. org/uploaded\_files/documents/10\_484\_communications\_paper. pdf, 20-09-2005.

http://www. fasb. org/articles&reports/framework. pdf, 05-10-2005.

http://www. fasb. org/project/conceptual\_framework. shtml, 22-06-2005.

http://www. fasb. org/project/conceptual\_framework. shtml, 22-06-2005.