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## CONVERGENCE EFFORTS ON THE ISSUE OF ACCOUNTING INFORMATION QUALITY CHARACTERISTICS

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### Abstract

*The issue of information quality is a key stone concept in the accounting world, as it supplies the ground for the decision making process. In the context of financial reporting convergence, this concept has went through a number of changes, in order to reach a general form understandable and suitable to all national accounting traditions aiming for IFRS adoption. The current paper presents the evolution of the concept, from its originating Anglo Saxon form, to the continental approach, offering at the same time an overall picture of the current generally accepted classes of characteristics and stages of adoption in the western world.*

**Keyword:** accounting information, quality characteristics, FASB, IFRS

**JEL Classification:** M41 M48

### Introduction

The issue of quality characteristics, alongside the sufficient quantity requirement, represents a central component that gives meaning to accounting information as it is employed by its user. In past practices, many accounting traditions have paid special attention to this subject, thus determining a set of standardized rules with mandatory character in presenting accounting information. In the context of globalization however, with much effort being put into financial reporting convergence, the regulatory organizations responsible with international standard setting were pushed into building a new status quo, where a unanimous rule over the issue of information quality characteristics represents the corner stone for the newly emerging system.

Given the broad definition of accounting, according to *Barron's Dictionary of Business Terms*, as being a system that reveals sufficient information of adequate quality



about an entity's finances – the logical first step in the process of harmonization would be to determine commonly accepted definitions for the basic building blocks of accounting; such as accounting information, sufficient quantity rule, or quality characteristics. This task has proven to be rather difficult due to the difference in opinion shared by various national regulatory institutions. With regards to the quality issue of accounting information, we are commonly faced with two distinct traditions that offer a larger or lesser degree of importance to the subject. The current paper aims to explain the evolution of opinions and the compromises that were required in order for the opposing traditions to accept a common language. This, in turn, will also facilitate further understanding of the rationale behind the current dichotomy of quality characteristics.

### **The evolution of the accounting quality information concept**

The experience of the great depression in the United States has revealed the need for reform, in a sense that certain regulations should be put into place in order to avoid future similar economic catastrophes. In the opinion of various members of the US legislature during the period, the economic depression in which the country was plunged was also partly due to the fact that large public corporations failed to present pertinent and sufficient accounting information to its investors. The effort of regulating all aspects regarding the quality of accounting information, however, did not reach an end point until 1980; when the *Federal Accounting Standards Board (FASB)* has issued the regulatory paper called *Statement of Financial Accounting Concepts 2 (SFAC 2)*. Within the section *Qualitative Characteristics of Accounting Information*, FASB defines four distinct quality characteristics that must be met in presenting accounting information. In a similar fashion, the United Kingdom - another country of Anglo-Saxon accounting tradition, defines the quality concept and its characteristics through the normative act *Principle Presentation: Qualitative Characteristics of the Financial Information (Statement of Principle: The Qualitative Characteristics of Financial Information)* (Gheroge, 2012). The governing principles from both countries are also reflected in the *International Accounting Standard Board (IASB)* regulations of 1989:



Table 1 – Quality Characteristics of accounting information in the Anglo-Saxon world and IFRS

US Quality Characteristics as defined by FASB	International Quality Characteristics as defined by IASB	UK Quality Characteristics as defined by Accounting Standards Board (ASB)
Intelligibility	Understandability	Relevance
Relevance	Relevance	Credibility
Comparability	Reliability	Comparability
Credibility	Comparability	Comprehensiveness

Source: author's summary of Rusu, 2013

The definitions of the characteristics from Table 1 are not given, since for the purpose of the present paper they are considered obsolete in the light of more recent regulatory acts. It is important to note, however, that all of the three regulatory bodies define the four characteristics of accounting information quality using synonymous terms. Furthermore, the following circumstantial and historical evidence lead to the conclusion that the choice of terms employed by the international system, is not a coincidence, but is the result of a large degree of influence that the Anglo-Saxon world holds over the *International Financial Reporting Standards (IFRS)*:

*Historical evidence that explains FASB's influence in the development of IFRS:*

In the aftermath of its creation in 1973, FASB took a non supportive stance towards IASC's efforts, as it considered its jurisdiction lacking authority. The US Securities and Exchange Commission (SEC), on the other hand, continued its support for the international standard effort, eventually forcing the reconciliation between FASB and IASC/IASB. As a result of more than twenty years of mutual support, a number of noticeable compromises have influenced the development in international standards (Domil et al, 2015):

- the formation of the IASC G4+1 consultancy group (whose membership is made up entirely of Anglo Saxon countries, among which we count the US and the UK),
- the adoption of certain international standards (such as IAS 39 for example) are in complete accord with US *General Accepted Accounting Principles (GAAP)*
- The United States is currently represented by more delegates in the IASB board, than any other country (e.g. US has five standing members, while countries such as France or Germany, is represented by one member each)

*Resulting circumstantial evidence:*



- FASB, ASB and IASB define the governing terms that make up the accounting information quality characteristics slightly different, but reference the same properties.

The contrasting views of the three distinct financial reporting regulating bodies are visible only at the level of certain secondary characteristics and restrictive characteristics upon the four major ones cited above. For example, while FASB restricts the four majors through the material principle (the use of professional judgment in determining what information should be rendered, depending upon if its quantum is above the pre-set material level) and the cost benefit trade-off (the cost of gathering accounting information must be less than the benefit it brings); IFRS also restricts the major characteristics through the concept of presentation in timely manner and by stating the need for an equilibrium in applying the four major characteristics.

The above hinted influence of the Anglo-Saxon world over the development of IFRS' opinion on the subject is even more so obvious in the context of the 2010 IASB – FASB common manifesto: *Conceptual Framework for Financial Reporting; Chapter 3: Qualitative Characteristics of Useful Financial Information*. As a result of this act, both FASB and IASB officially converge to the same values that shape the concept of accounting information quality. Thus, the accounting information quality characteristics are divided into two groups: the fundamental characteristics (i.e. relevance and faithful representation) and enhancing characteristics (i.e. comparability, verifiability, timeliness, understandability); all being restricted by the concepts of materiality, predictive value, completeness, neutrality, confirmatory capacity, and presentation lacking error (Rusu, 2013).

The contrasting case to the Anglo-Saxon and the Anglo-Saxon influenced IFRS, is the continental European approach on the subject matter. The continental tradition, throughout its development, has paid less attention to the subject, as it did not put excessive effort into developing a clear hierarchy of terms that define the qualitative aspect of accounting information. To this end, the French *National Accounting Counsel* – for example, only mentions the concept of accounting information quality, without giving explicit indications: “the accounting information should offer its users a clear, complete and faithful representation of operations, events and statements of an economic nature” (Gheroghe, 2012). Furthermore, neither the European Council's IVth nor VIIth directives, with regards to financial statements and consolidated financial statements, give a procedural guideline on the subject. This normative literature uses, however, terms such as just and faithful representation, the use of prudence in assessment, consistence in method application from one period to the next, etc.

The freedom granted by the European Parliament rule #1606/2002, that requires financial reporting based on IFRS for publicly traded corporations, and (arguably) the increasing demand by the private sector for financial reporting normalization has led to a



certain degree of adoption of the Anglo-Saxon approach towards accounting information quality by the legislation of some European Union member states. One such example is Spain, whose accounting legislation of 2007 defines concise quality characteristics, divided into two groups – a main group, made out of relevance and credibility, and an auxiliary group made out of comparability and clarity (Rusu, 2013). Another case of legislature being receptive to the IFRS model is section 2.2 of Romania's Ministry of Finance ordinance #3055/2009, which for the first time in this country's case has defined four quality characteristics: intelligibility, relevance, credibility and comparability. Later, in 2014, through ordinance #1804/2014 Romania has completely aligned its accounting practice, in as far as the qualitative aspect of accounting information, to the FASB-IASB model. Romania, therefore, requires quality information to meet a number of two fundamental characteristics (relevance and faithful representation), along with a set of enhancing characteristics (intelligibility, comparability, verifiability, and time usefulness)(OMFP 1802/2014, art 29-46).

Although this may be subject to further research, the ease of adoption in Spain and Romania of IFRS concepts on the subject may also be due to their accounting traditions starting a new in the context of the post Franco regime in 1975 Spain, and the 1989 fall of the communist regime in Romania, respectively. In the case of Romania, at least, there is sufficient evidence to support the statement that during the post communist struggle for accounting reform, the academia has promoted change that made possible the cohabitation between the former patrimonial tradition and the need for IFRS adoption (Ionascu, 2010). With regards to the issue at hand, especially between 2009 and 2014 (the year of the first quality characteristics implementation by ordinance 3055, and the year when the FASB-IASB model was adopted by means of ordinance 1804), a great deal of attention was paid to understanding the role and mechanics of quality information. The shift in characteristics from the 2009 ordinance to the current 2014 form, has kept the same meaning for the defining terms, but has added depth to their due order. Therefore, relevance – the information's capacity in aiding the user in evaluating past, present and future events by confirming or infirming certain matters of fact regarding the entity (Vataosiu, 2010), has been explicitly made subject to the materiality and cost-benefit tradeoff restrictions. Relevance, alongside faithful representation, which has replaced the previous term of credibility (also currently subject to the restriction of completeness, neutral and error lacking representation), make up the fundamental characteristics for accounting information quality. The remainder of previous main characteristics: intelligibility and comparability, in addition to verifiability and time usefulness, become amplifying characteristics not in a sense of lesser importance, but in a sense of bringing additional contributions towards achieving the goal of the first two. Overall, the evolution in the Romanian legislation, as it does not change the fundamental definitions of the terms characterizing the quality aspect of accounting information, does not aim for a paradigm



shift. It simply drifts away from the continental tradition, by adopting a more rigid hierarchy, adjusted to the local context and in accord with the successfully proven IFRS; for the end goal of facilitating a better global analysis of an economic entity by its stakeholders and other accounting information users.

## **Conclusion**

The concept of accounting information quality is an innovation that has generated much debate among accounting regulating institutions involved in the financial reporting harmonization process. The need for principles that govern the quality aspect of accounting information has risen from the US experience of the great economic depression. By the latter part of the XXth century, both the US and the UK - another country of Anglo-Saxon and capitalistic market background, have managed to issue similar principles on governing the treatment of accounting information quality; principles which in turn have influenced the development IASB's opinion. Opposite to the laissez faire thinking of the colonial world is the more social-democrat and patrimonial oriented continental European tradition. In the accounting practice of the old continent, the treatment of information quality does not share the same complexity. The context of globalization, however, has shortened the gap between the two worlds. The support of the European Council for the international effort of accounting convergence has made it possible for member states to adopt various aspects from the IFRS model.

The two countries, cited as examples, that have undertaken recent reform in the field of accounting, reveal the need for approaching the subject matter at a deeper level. The more recent Spanish and Romanian legislations reflect the view and enforce the characteristics and hierarchy suggested by the IFRS. Therefore, with regards to the issue of accounting quality at least, present evidence indicates that the Spanish and Romanian cases sit at the fore front of recognizing the need for a result oriented way of accounting thinking, similar to the one promoted by the Anglo-Saxon world. IFRS, with the support of the European Council, is the binder between the Anglo-Saxon and continental traditions on the issue, combining general concepts from both traditional groups, in a flexible manner suitable for professional interpretation, and offering a strict hierarchical definition of terms, while giving room for adaptation to local national context.

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