Al-Mustaqbal university college

Conceptual Framework for Financial Reporting

3

First Level: Basic Objectives

Second Level: Fundamental Concepts

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CHAPTER 2

Conceptual Framework for Financial Reporting

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the usefulness of a conceptual framework.
2. Describe the FASB's efforts to construct a conceptual framework.
3. Understand the objective of financial reporting.
4. Identify the qualitative characteristics of accounting information.
5. Define the basic elements of financial statements.
6. Describe the basic assumptions of accounting.
7. Explain the application of the basic principles of accounting.
8. Describe the impact that the cost constraint has on reporting accounting information.

First Level: Basic Objectives

Objective of financial reporting:

To provide financial information about the reporting entity that is **useful to present and potential equity investors, lenders, and other creditors in making decisions about providing resources to the entity**.

First Level: Basic Objectives

Question

According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on?

a. Generally accepted accounting principles

b. Reporting on management's stewardship.

c. The need for conservatism.

d. The needs of the users of the information.

LO 3 Understand the objectives of financial reporting.

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Second Level: Fundamental Concepts

Qualitative Characteristics of Accounting Information

“The **FASB** identified the **qualitative characteristics** of accounting information that distinguish better (more useful) information from inferior (less useful) information for decision-making purposes.”

Second Level: Fundamental Concepts

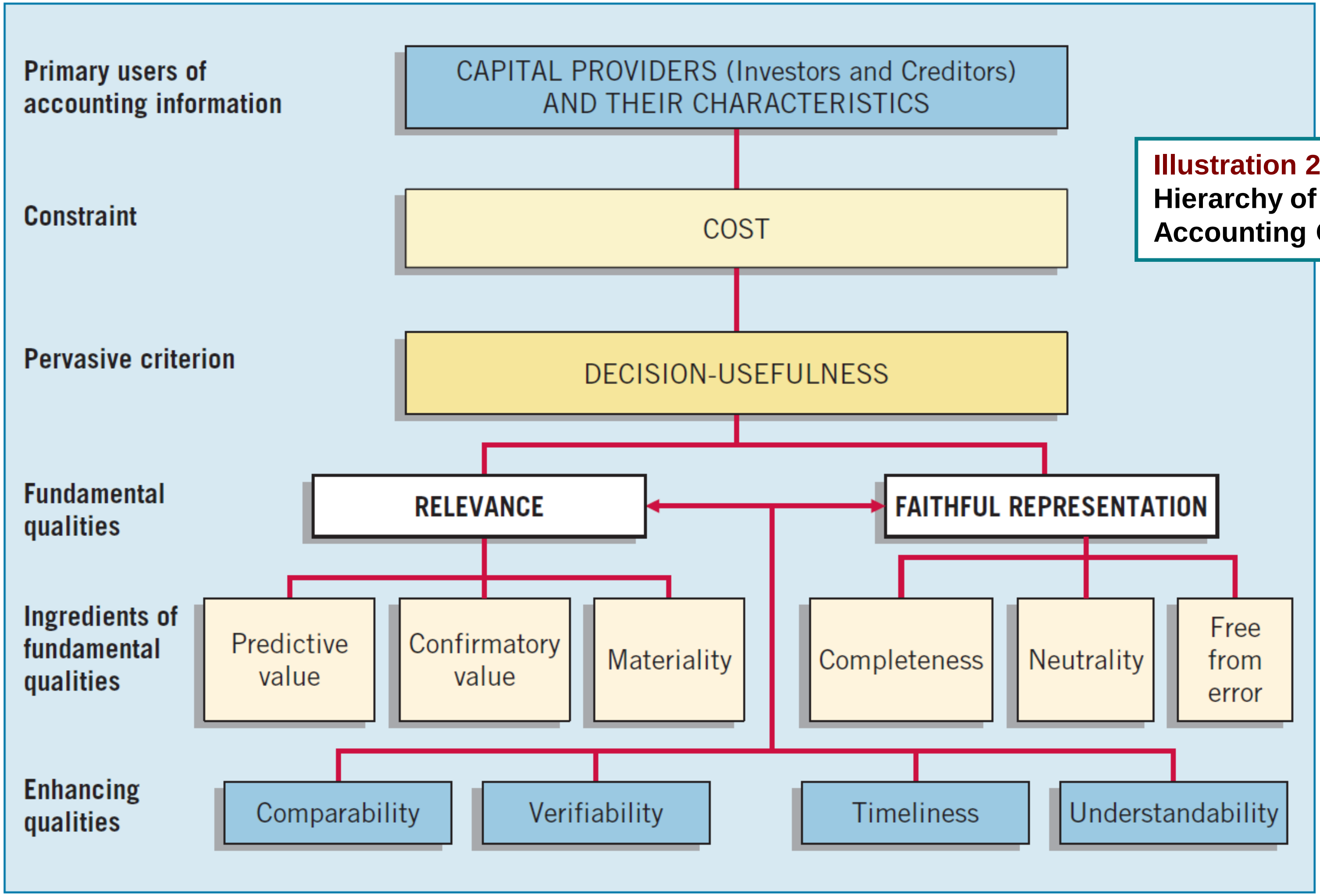


Illustration 2-2
Hierarchy of Accounting Qualities

LO 4 Identify the qualitative characteristics of accounting information.

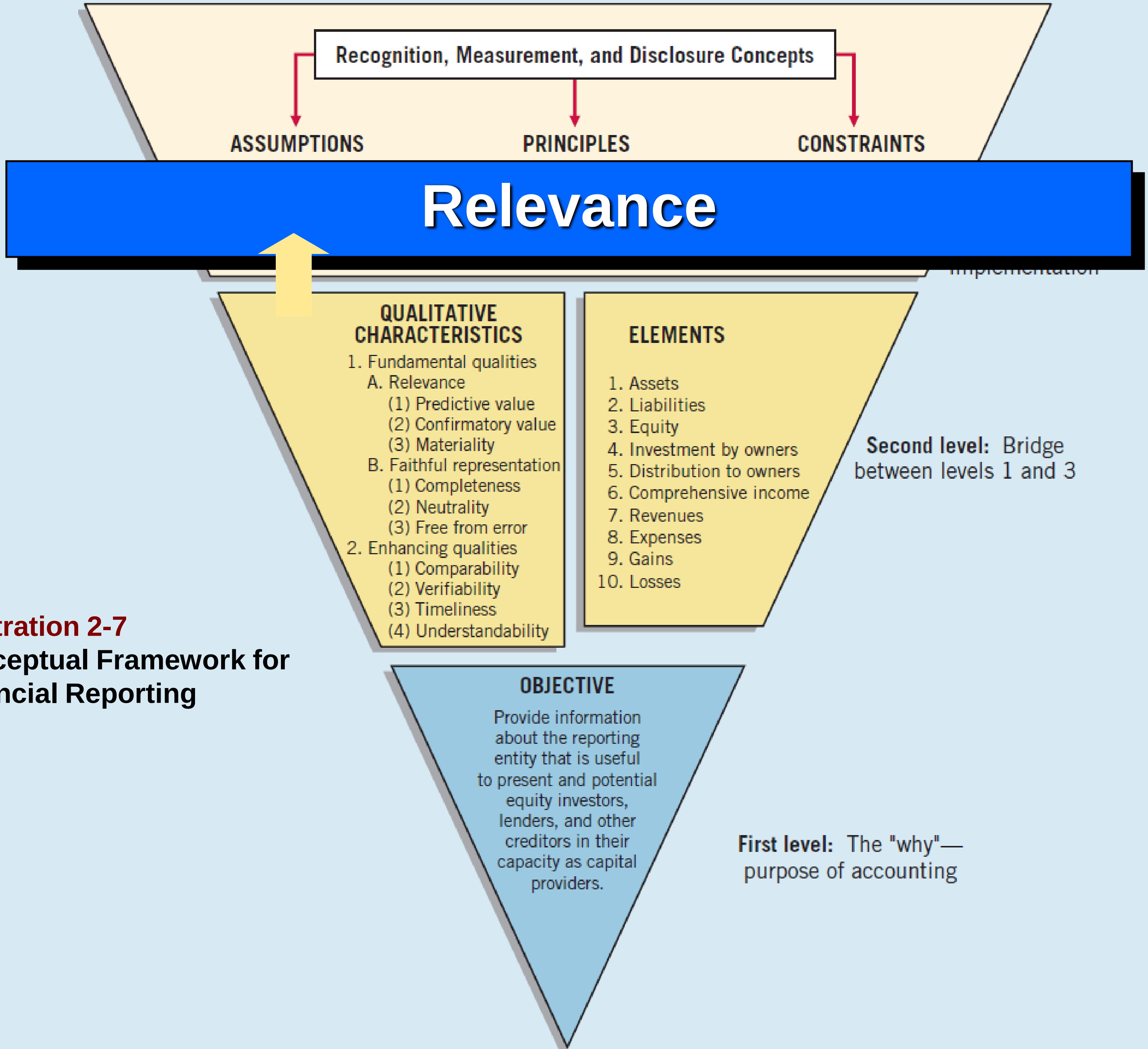
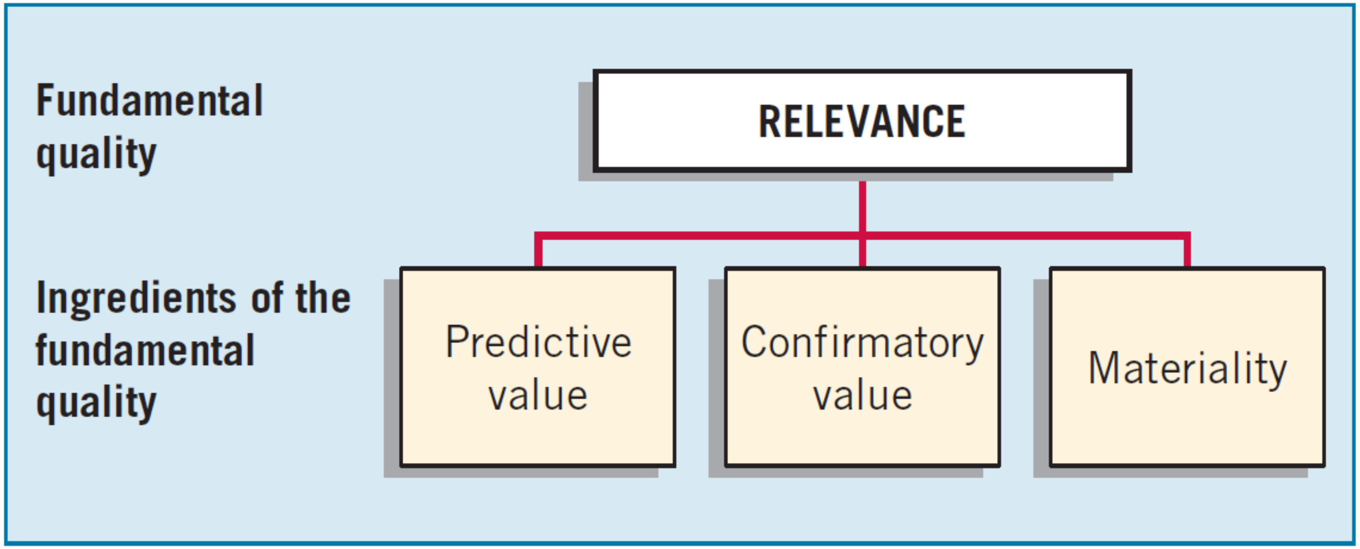


Illustration 2-7
Conceptual Framework for Financial Reporting

Second Level: Fundamental Concepts

Fundamental Quality—Relevance

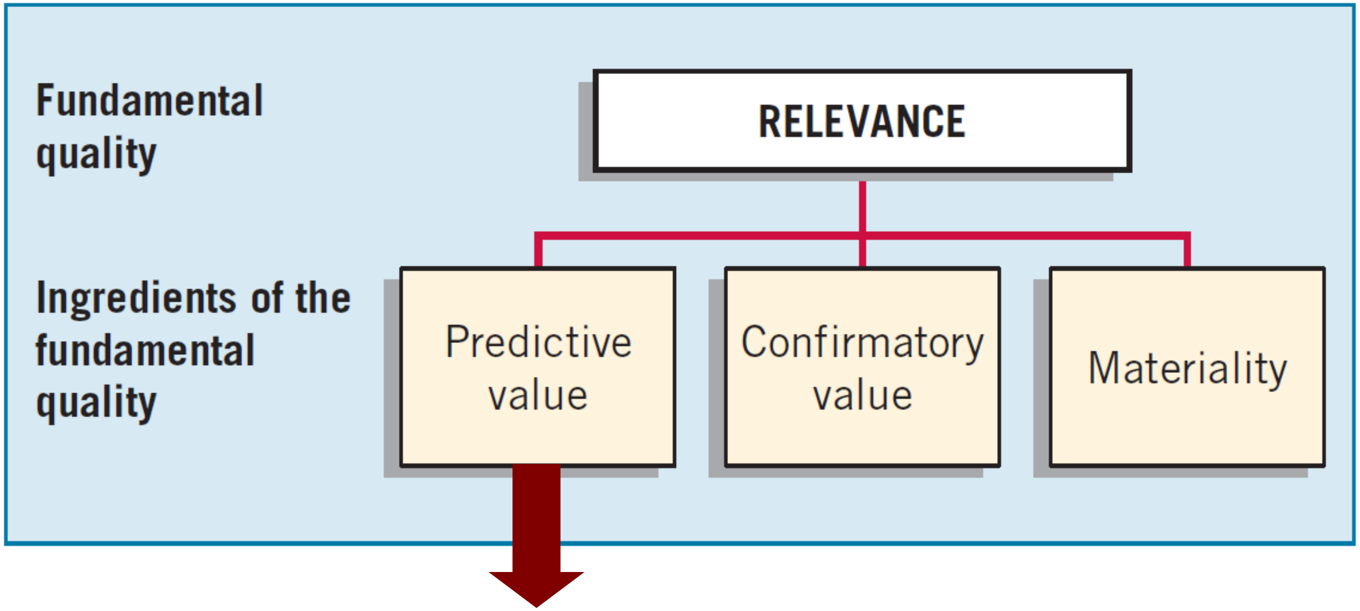


To be **relevant**, accounting information must be capable of **making a difference in a decision**.

LO 4 Identify the qualitative characteristics of accounting information.

Second Level: Fundamental Concepts

Fundamental Quality—Relevance

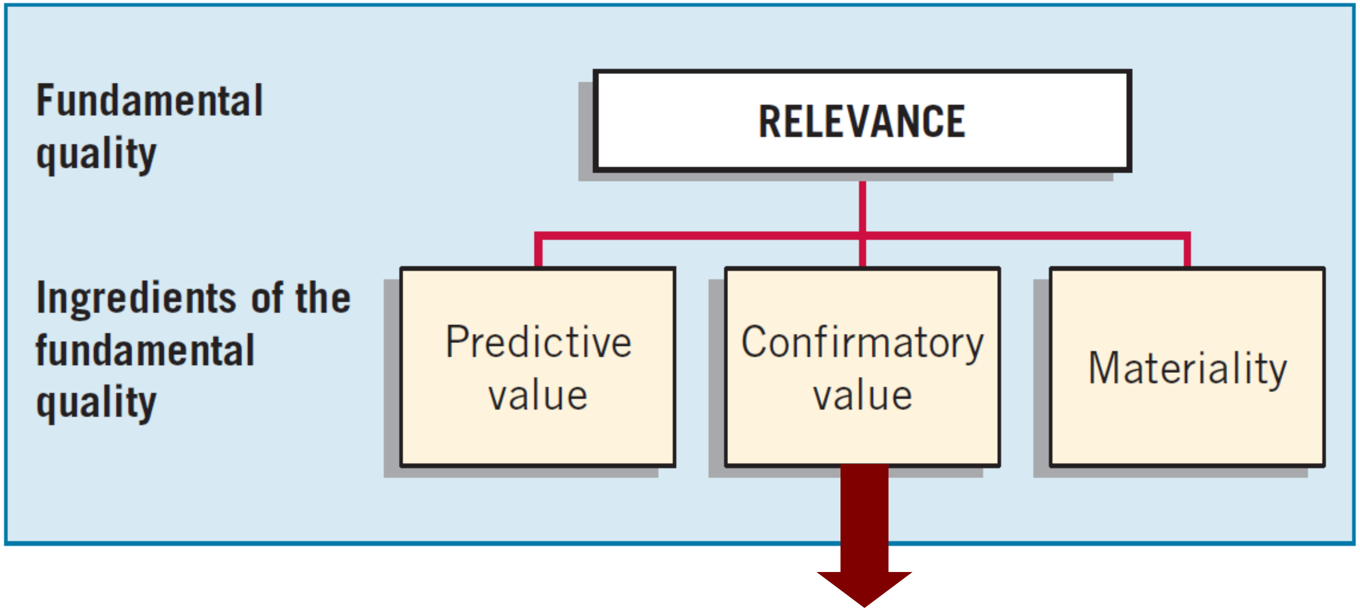


Financial information has **predictive value** if it has value as an input to predictive processes used by investors to form their own expectations about the future.

LO 4 Identify the qualitative characteristics of accounting information.

Second Level: Fundamental Concepts

Fundamental Quality—Relevance

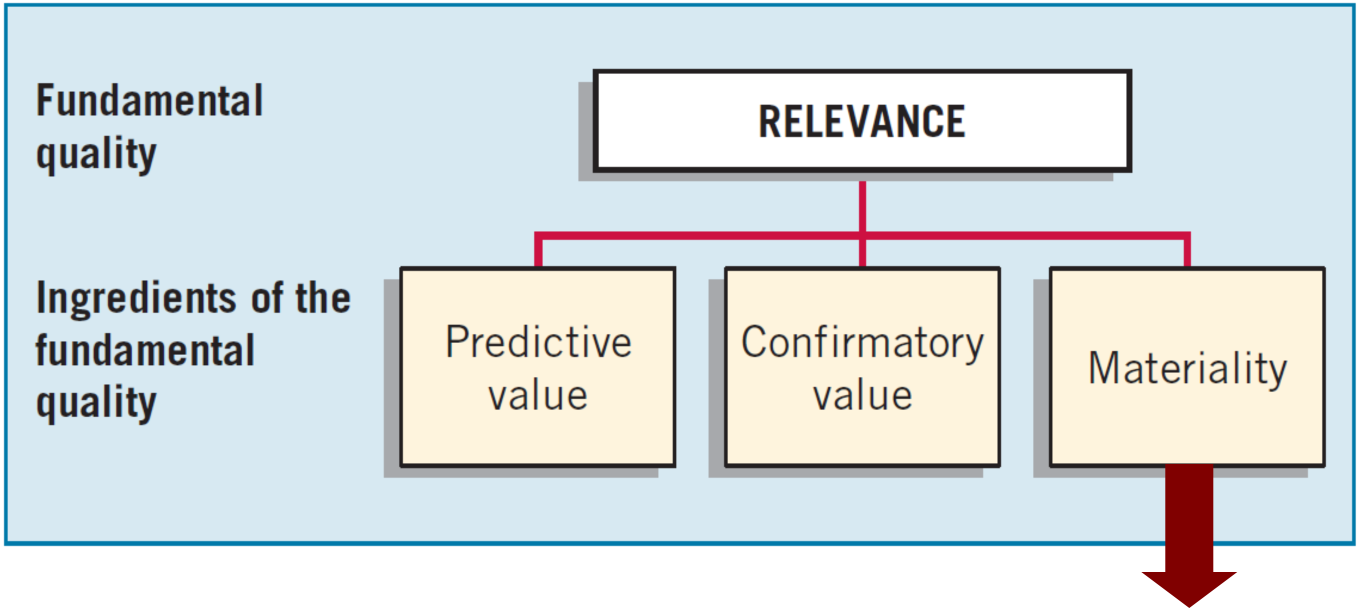


Relevant information also helps users **confirm** or correct prior expectations.

LO 4 Identify the qualitative characteristics of accounting information.

Second Level: Fundamental Concepts

Fundamental Quality—Relevance



Information is **material** if omitting it or misstating it could influence decisions that users make on the basis of the reported financial information.

LO 4 Identify the qualitative characteristics of accounting information.

What do the numbers mean? LIVING IN A MATERIAL WORLD

The first line of defense for many companies caught "cooking the books" had been to argue that a questionable accounting item is immaterial. That defense did not work so well in the wake of accounting meltdowns at Enron and Global Crossing and the tougher rules on materiality issued by the SEC (SAB 99). For example, the SEC alleged in a case against Sunbeam that the company's many immaterial adjustments added up to a material misstatement that misled investors about the company's financial position. More recently, the SEC called for a number of companies, such as Jack in the Box, McDonald's, and AIG, to restate prior financial statements for the effects of incorrect accounting. In some cases, the restatements did not meet traditional materiality thresholds. Don Nicholaisen, then SEC Chief Accountant, observed that whether the amount is material or not-material, some transactions appear to be "flat out intended to mislead investors." In essence he is saying that any wrong accounting for a transaction can represent important information to the users of financial statements. Responding to new concerns about materiality, blue-chip companies such as IBM and General Electric are providing expanded disclosures of transactions that used to fall below the materiality radar.

LO 4 Identify the qualitative characteristics of accounting information.