St. Lawrence High School

A Jesuit Christian Minority Institution

Study Material 2

Sub: ACCOUNTANCY Class 11

Chapter: Unit 1: Introduction to Accounting Date: 30/06/2020

Topic: Accounting 2

Qualitative Characteristics of Accounting Information

Accounting information must possess some qualitative characteristics. These are the attributes that make the information provided in financial statements useful to users. The four main characteristics are
(1) Reliability
(2) Relevance
(3) Understandability
(4) Comparability
All those characteristics are discussed as under.

(1) Reliability

Accounting information should be reliable. Reliability is the characteristic of accounting information which gives the user confidence and trust that the reported information is a reasonable representation of the actual items or events that have occurred. To be reliable, the accounting information should be error-free and neutral- an accountant's bias must not colour his information.

- Faithful representation: Information must faithfully represent the effects of transactions and other events. If the information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and present in accordance with their substance and economic reality and not merely their legal form.
- Neutrality: Judgement is required in arriving at many items in the financial statements. Judgement is involved in valuing closing stock, determining the amount of doubtful debts etc. Neutrality means that these judgements are made without any bias.
- Prudence: Caution must be exercised while preparing financial statements and estimating the outcome of uncertain events. The financial statements must not be prepared on the most optimistic bias.
- Completeness: The information in the financial statements must be complete within the bounds of materiality and cost.

(2) Relevance

Accounting information must be relevant to the user. Information is relevant if it meets the needs of the user in decision making. Relevance is defined in terms of the ability to affect a decision- makers course of action, because whether a particular set of accounting information is relevant or not depends on specific decision- makers objectives. Thus for information to be relevant, it must have some bearing on the decision being made. Relevant accounting information should be capable of making a difference in a decision by helping users of accounting information to form prediction about the outcomes of past, present and future events. The decision not to modify or correct previous actions is a very important one.

Financial information which does not have relevance to users is worse than no information at all, i.e. any information does not connote utility if it is not relevant to the purpose. To be relevant, it should be capable of monetary computation.

(3) Understandability

Understandability is the quality of accounting information that enables users to perceive its significance, i.e. to understand the content and significance of accounting statements and reports. If a user cannot understand the accounting information given to him, it is not useful, even though it may be relevant to whatever decision he wants to make. To have the characteristics of understandability, accounting information must be presented in a manner that users can understand, i.e. it must be expressed in terminology that is understandable to the users.

Now –a-days, business activities and transactions have become increasingly complex. It may not always be possible to describe complex transactions in simple terms. It is, therefore, necessary that the users of accounting information must attain a minimum level of competence in understanding the terminology used in accounting statements.

It is assumed that the users have a basic knowledge of business accounting, and they will spend some time and effort in studying the accounting statements. However, the accountant has a basic responsibility to describe business transactions clearly and concisely.

(4) Comparability

Usefulness is enhanced if accounting information can be compared with similar information for the same organization at different times, and for different organizations at the same time. Comparability enhances the value of accounting information by enabling the users to discern and detect similarities and the dissimilarities among different concerns as also in respect of the same concern over time. Absoluteness of the information is not of much use- it is comparatively that lends itself to proper decision making. Whether one is doing well or not is not the enquiry; the enquiry should be whether one is doing better or more (or worse) than others or than in other periods. To achieve comparability, consistency and disclosure of accounting policies are necessary. These are as follows:

- Consistency: once chosen, an accounting basis should not be changed unless it is necessary to conform to the conservatism concept, which is of greatest importance.
- Disclosure: It is an accounting principle that requires full (adequate) disclosure of all material (significant) matters affecting the financial statements that would be of interest to the users of accounting information.

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