FASB, Investors, and disclosure

The financial accounting standard (FASB) recognizes the existence of a diverse and pluralistic user group, but most often focuses on investors and creditors. Has this always been the case? How useful is accounting information?

This activity explores some of these issues.

Exercise One

Davis, Menon, and Morgan suggest that four successive metaphors or images have shapes our thinking over the past 60 years with respect to financial reporting, accounting as an historical record, accounting as a mirror of economic income, accounting as an information system and accounting as an economic commodity. Think about these metaphors and try to match them to each of the following

 \*The FASBs view \_\_\_\_\_\_\_\_\_\_. (information system)

 \*the agency perspective on \_\_\_\_\_\_\_\_\_\_\_the role on accounting data (historical record)

 \*each of the following sets of users…

 -owners\_\_\_\_\_\_ (mirror)

 -external investors \_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_ (information system, commodity)

 -contracting parties with the firm \_\_\_\_\_\_\_\_\_ (historical record)

Exercise 2

You are committed to the concept if lifelong learning and as a result, have enrolled for a training seminar featuring an accounting professional. The focus of the seminar is on the FASB and accounting information. The part of the seminar that you are looking forward to is the interactive session in which you get to engage in the questions and answers with the featured expert, Dr Jim Chan.

Dr Chan’s interactive session begins shortly after mid-day. He starts by posing a question

The usefulness if accounting data to investors and creditors for predictive purposes is necessarily forward looking. Under generally accepted accounting principles, however, financial statements are constructed primarily as an historical record. What limitation do you think this imposes on the usefulness of financial statements for predictive purposes?

Answer…

The FASB conceives of accounting as an information system with the emphasis mainly on prospective cash flows. Because accounting systems are, by construction, historical records, they are necessarily backward-looking. So feedback value is going to be better achieved than predictive value.

Based on your feedback and responses from other audience members, Dr Chan continues

If this is the case, why do you suggest that the feedback value to investors and creditors, even predictive value is not necessarily high?

Answer…

I further suggest that if accounting is primarily a feedback system, it is nevertheless useful precisely for this reason. From a contracting perspective, accounting is important in bringing about control and accountability to investors and creditors, and it is for this reason that accounting numbers are used in writing contracts, such as debt contracts with restrictive covenants and incentive compensation agreements. Also, feedback and accountability do have significance for helping users to predict cash flows.

Dr Chan’s is getting ready to wrap things up, but ask the audience one final question.

In order for the accounting information to be useful, issues of disclosure and uniformity are important. From your perspective, what is the relationship between uniformity, both finite and rigid and disclosure?

Answer…

I argue that this is mostly a case of complementarily. Uniformity, in terms of employing finite where it is feasible and cost effective, and using rigid where it is not. Both require extensive disclosures to further bring about comparability. Finite uniformity may require more extensive disclosure than rigid as a means of explaining and justifying the event alternatives that have been taken. There is much disclosure that simply cannot be squeezed into the body of the financials segmental disclosure.