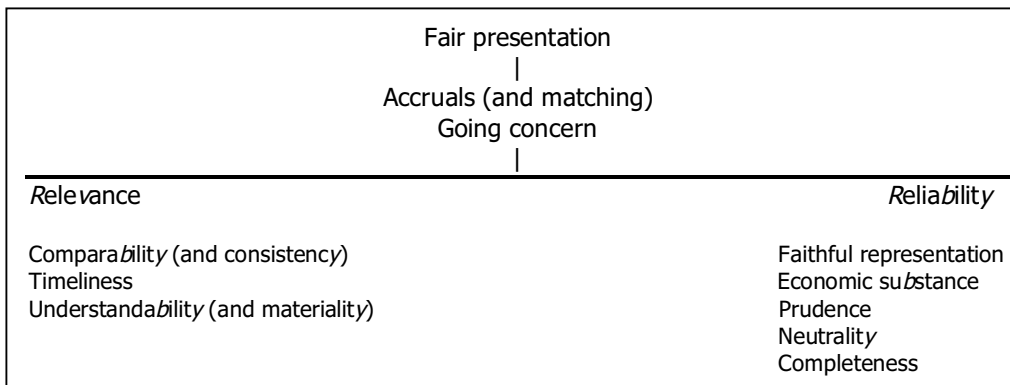


To what extent is the search for relevance in financial information hampered by the need for reliability?

Shortly after its formation in 1973, The International Accounting Standards Committee (henceforth referred to as IASC) conferred to introduce a conceptual framework that outlines basic concepts and assumptions, which must all be considered to order to produce financial information. The essential purpose of framework being to provide a ‘fair presentation’ of the state of affairs of certain businesses. What ‘fair presentation’ means exactly is not clear, but an assumption we can make about this is that the financial information *must not be misleading to the users in any way*. This framework can be read (in an adapted format) as follows:



Here we are able to split this framework into three levels. With level A (fair presentation being the overall objective. This is thus supported by level B ‘concepts’ (relevance and reliability) and level C ‘rules.’ (Those, which underline the level B concepts) Within this exercise we wish to examine how the concepts and rules conflict each other in the pursuit for the fair presentation of financial information. Firstly we must define what relevance and reliability mean in an accounting perspective.

*Relevance: When preparing financial statements we must take into account a few simple considerations. We need to know for who to information is intended, what they do and what they need for the future. Relevance also relates to the actual credibility and usefulness of financial information and the provision of predictions of future*

*economic happenings. To do this one must use the past and the present as a base because here we can understand how other situations have hitherto affected the business so as to fully benefit from advantageous situations and to protect itself in more difficult periods*

Reliability: *Relating to the dependency of the provided financial information. This concept is undertaken to prevent the release of information, which may be detrimental to the business entity in the future.*

We immediately realise that some sort of compromise has to be reached in order to achieve the level A objective. What use is financial information that is relevant but unreliable, likewise information that is reliable but irrelevant.

#### Timeliness versus Completeness

The concept of timeliness states that the information provided by accountants is as up-to-date as possible. However, since it takes time to present reliable information it soon becomes rather 'out-of-date.' This conflict of ideas is becoming more and more prominent since companies are becoming increasingly demanding regarding the frequency of their external reporting.

#### Understandability

“In a complex world, information may have to be complex in language in order to achieve fair presentation.” IAS 1 allows the preparers to assume that the users are sufficiently intelligent to comprehend the information that is given to them so that it is useful to them. In the real world however, this is not always the case and, given the amount of specialist language within the accounting sphere, users may be phased by the complexity and may not interpret certain elements correctly thus leading to a certain amount of unreliability.

#### Materiality

“ This implies that insignificant items should not be given the same emphasis as significant items. The insignificant items are, by definition, unlikely to influence

decisions or provide useful information to decision makers, but they will cause complications to the user of accounts.” This thus allows yet more subjectivity to creep into the accounting process. Complete disclosure of all items in financial information may lead to complete reliability but will lead to much irrelevancy and confusion.

We have noted some conflicts that exist between relevance and reliability. It is necessary in addition to statement a major conflict within the scope of reliability, this being the conflict between neutrality and prudence. Neutrality states freedom from any form bias whereas the idea of prudence requires us to bias information so as not to overstate profits, turnover, assets etc. In essence this is simply the prevention of creating the picture of the business looking too healthy. We must immediately concede that a certain amount of either has to exist in the final accounts, because a total presence of one element will mislead to user and this is the ‘cardinal sin’ that can be committed amongst financial reporters. Now we must consider which is the more relevant of these two ideas to adopt, as a majority factor.

This can all be reduced to a question of risk and thus a choice in the policy that a company wishes to adopt for the future. For example if one were to be conservative and choose reliability then it's true that the business would continue to operate with stability but, by definition, gives little room for large changes (in either direction) in economic activity. Whereas if the users were to be partial towards relevance then the company may experience greater change in activity due to the increased relevance, however given the element of sacrificed reliability, this change may lead to a reduction in turnover/profit. Respectively prudence and neutrality behave in a similar way with respect to the risk involved.

Based on the assumption that no owner wants to be based at either of these extremes, most companies would therefore search for an appropriate compromise between the two ideas; a compromise that allows us to achieve a set of published financial statements that perhaps reflects the desired amount of risk to be taken by the user of accounts.

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**Basic Accounting A**

**“To what extent is the need for  
relevance in financial information  
hampered by the need for  
reliability?”**