# THE COHERENCE OF IASB REQUIREMENTS REGARDING THE QUALITY OF FINANCIAL INFORMATION WITH THE NEEDS OF FINANCIAL ANALYSIS

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**Abstract**

*In this article we will present the need for quality financial information in a globalized economy. In the context of the international accounting harmonization phenomenon, the quality of financial and accounting information has improved considerably. The abundance of information allows organizations to increase their informational competitiveness parameters in relation to domestic and international competitors. Also, the characteristics of financial information will be presented from the perspective of the needs of financial analysis, because in order for the information to be useful in the managerial process, it must meet a number of main qualitative characteristics.*

**Keywords:** *characteristics of financial information, the utility of financial information, the production of financial - accounting information*

**JEL Classification:** G3; G32; G34

## 1. Introduction

The use of IFRS by companies represents, in the understanding of the IASB, a greater guarantee of financial transparency. According to the Conceptual Framework for the Preparation of Financial Statements, "the general objective of financial reporting is to provide financial information on the reporting entity, useful to existing and potential investors, lenders and other creditors in the decisions they have to take about providing resources to the entity.

Decisions to purchase/retain/dispose of shares or debt depend on the returns expected by the owners, as well as the assessment of uncertainties related to future cash flows affecting the entity. Investors must therefore have access to financial statements that best reflect the resources controlled by the entity and the rights of third parties over it. They have the right to know the financial risks to which the entity is exposed. Finally, they need information that is directly comparable from one company to another in order to better allocate/invest capital without incurring unnecessary information reprocessing costs. Better than any other national reference, international financial reporting standards fulfill these objectives because they privilege the "translation" of economic reality in favor of often misleading legal appearances.

## 2. The need for quality financial information in a globalized economy

In the context of the phenomenon of international accounting harmonization, the quality of financial-accounting information has improved considerably. The abundance of information allows organizations to increase their informational competitiveness parameters in relation to domestic and international competitors.

In terms of this complexity, financial information in the modern economy has many meanings depending on the users. As the objectives pursued by users of financial statements are different, the financial analysis will be carried out in different ways. This demonstrates the importance and complexity of financial analysis.

All categories of users look at financial information from different angles. Whether they are interested in risks, profitability, debt capacity or loan repayment, users expect the entity to provide the necessary transparency for their expectations through published financial statements. Certainly the adoption of IFRS worldwide will bring advantages to investors.

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It is obvious that financial statements cannot meet all the information needs of users. Thus, considering the fact that the people who invest in an entity risk perhaps the most, the preparation of financial statements for them should also provide the other categories of users with the information necessary to make the right decisions. However, in a functioning economy based on competition, it is important to maintain a balance between the needs of each category of users and not to focus only on a series of information specific to a certain category.

The users of financial information in the modern economy can be classified as follows:

⇨ Investors and financial markets – investors are interested in the risks that their investment may face and the profit that can be earned. Shareholders are interested in information that enables them to determine the company's ability to pay dividends. Financial Market Authorities need information on listed companies in order to perform regulatory functions and better protect investors.

⇨ Employees and trade unions – they are interested in reliable financial information that will allow them to assess the stability and profitability of the company.

⇨ Clients – they are interested in financial information that allows the continuity of the company's activity, mainly as long as they have a partnership contract.

⇨ Financial creditors – they are interested in information that allows them to assess the debt and repayment capacity of the company.

⇨ Suppliers and other debtors – suppliers are interested in financial information that allows them to determine whether the credits granted will be paid when due: assessing the repayment capacity of the company.

⇨ The state and its bodies - they are interested in the financial information that allows the assessment of the distribution of resources and implicitly the activity of the company. They may require the publication of new information by regulating the activity of companies in order to determine tax policies and the basis for calculating national income.

Given this need for financial information, we must highlight the fact that the possession, manipulation and use of information can improve the cost-effectiveness ratio in many physical or cognitive processes. As an individual and social resource, the information has several characteristics that distinguish it from the traditional notion of an economic resource.

## 3. Characteristics of financial information from the perspective of financial analysis needs

For the information to be useful in the managerial process, it must meet a number of main qualitative characteristics. The specialized literature delimits the qualitative characteristics of accounting information into two groups: the first group, specific to accounting information in which relevance and accurate representation are included, and the second group, specific to the user, in which intelligibility, comparability, verifiability and opportunity are included.

Qualitative characteristics are the attributes that determine the usefulness of the information provided by the financial statements.

The usefulness of financial information represents a mixture of qualitative characteristics and generates added satisfaction for those who use it. The quality of the information provided by the financial statements depends on obtaining a true picture of the activity of any company. Financial information is the basis for decision makers who need data whose benefits outweigh the costs of obtaining it, and specific characteristics to be validated.

*Relevance of information* – relevant information has predictive and/or confirmatory value and is therefore capable of making the difference between decisions made by investors and lenders. Information has predictive value if it can be used as input to processes used in specifying future outcomes. They have confirmatory value if they provide feedback on previous predictions. The relevance of information is influenced by its nature and the threshold of significance. In certain cases, the nature of the information is sufficient by itself to determine its relevance. In other cases, both the nature and the threshold of significance are important. Information is significant if above a certain value level - significance threshold - the omission or misrepresentation is likely to influence users' decisions.

*Accurate representation* – an accurate representation is complete, neutral and error-free. Information is complete if a user can understand the phenomenon described. Thus, descriptions and explanations as well as numerical representations are needed. Information is neutral if it is selected and presented without reservation. In other words, it is not intentionally over/underrated. Neutral information does not mean that it has no impact on decisions. By definition, useful information affects decisions. Also, error free does not mean perfect but means that there are no errors in the process used to produce them and there are no errors in their description.

*Comparability* – users must be able to compare an entity's financial statements over time to identify trends in its financial position and performance. Thus, the measurement and presentation of the financial effect of the same transactions and events must be done in a consistent manner within an entity, and over time for that entity, and in a consistent manner across entities.

An important consequence of the quality of the information being comparable is that users are informed of the accounting policies used in the preparation of the financial statements and of any changes to those policies, as well as the effects of the changes. Users must be able to identify differences between the accounting policies for transactions and other similar events used by the same entity from period to period and the ones used by different entities. The need for comparability should not be confused with mere uniformity and should not become an impediment to the introduction of improved accounting policies. It is not appropriate for an entity to continue to highlight in the accounting, in the same manner, a transaction or other event if the adopted policy does not maintain the qualitative characteristics of relevance and accurate representation.

*Comprehensibility* – an essential quality of the information provided by financial statements is that it must be easily understood by users. For this purpose, it is assumed that the users have sufficient knowledge on conducting the business and the economic activities, knowledge on accounting concepts and are willing to study the information presented with due attention. However, information on some complex issues, which should be included in the financial statements because of their relevance, should not be excluded simply because they may be too difficult for some users to understand. Access to financial information should be limited only by the lack of sufficient knowledge on conducting the business and the economic activities.

*Verifiability* - implies a consensus between different measures. For example, the historical cost of land reported on a company's balance sheet is usually highly verifiable. The cost can be traced to a barter transaction or the purchase of land. However, the fair value of land is much more difficult to verify. The term objectivity is often related to verifiability. The historical cost of land is objective and easily verifiable, but the fair value of land is subjective, influenced by the appraiser's past experience and biases. A rating is difficult to verify, which makes it less secure for users.

*Timeliness* – the timeliness of information is its availability early enough to allow its use in the decision process. It is also important that the information is useful for decision making. The need for timely information requires companies to be able to provide information to external users on a regular basis.

**4. The Limits of Financial Information for Financial Analysis**

The production, provision and use of financial-accounting information is the basis of a pertinent financial analysis. However, between the accounting system and the provision of real and complete economic information there is a mutual conditioning - or, rather, it would be ideal to exist - in the current conditions marked by deep imbalances, when it would be vital to create a link between production, certification and use of information. It is known that financial information, as a fundamental element of financial markets, can improve economic performance in multiple ways.

Accounting communication consists of the data considered most appropriate to recreate the reality of the company before eventually influencing the receiver's choices and actions. The representation of this reality must be considered an attribute of information, without which it could have no value. The dissemination of accounting information represents a "game" of rules that ensure the continuity of the relationship between the company and its environment.

We must not forget that this type of information dissemination is also a matter of power. The temptation of manipulation and privacy is ever more present if we refer to the recent financial scandals that have cast doubt on the quality of accounting information since companies that were on the heights of success based on periodic reporting suddenly went bankrupt.

In this context, the shortcomings to which financial information users are subjected, through the financial statements published by entities, are numerous. These are generated by the characteristics of the information contained in the summary documents that are aimed at the past and do not favor the relevance of decisions that have a view to the future. At the same time, some information contained in the financial statements is based on estimates of various quantities, which determines that they have a subjective character.

Even though companies are often tempted to make public only certain information, the decision in this regard is conditioned by the expectations of the users of accounting information. They must be able to determine, based on the information received, the indicators that refer to the company's profitability, liquidity and solvency.

Determining the profitability of a company involves analyzing the amounts in the profit and loss account. But, not all indicators in this situation meet the needs of users, in the sense that they are also estimated values that refer to events that have taken place. Such estimated sizes are those that refer to depreciation and provisions and that influence the company's accounting profit.

Therefore, the profit highlighted in the income statement or an increase in it does not necessarily provide favorable information to users. It is possible that this increase is due to the use of a particular accounting option or a change in accounting methods. In order to analyze a company's profitability, users would also need information that would allow them to make comparisons with other businesses, not only comparisons over time for the same company. Spatial comparisons are sometimes irrelevant in the sense that companies may use different accounting policies, making the accounting information of different companies not comparable.

In addition to the profitability of a company, users are also interested in the degree of liquidity of the entity, which takes into account current assets and liabilities. At a first look at the financial statements, users could notice what is the ratio between current assets and liabilities and whether the company has liquidity or not. However, the company's liquidity is interpretable, just as the concepts of "current assets and liabilities" are interpretable, in the sense that those elements that will be realized within 12 months from the balance sheet date are current. In order to correctly analyze the degree of liquidity, the rate system must be used. Then, the users of the accounting information are interested in the ability of the company to generate profit, on one hand, and the financial risk to which it might be subjected, on the other hand. Neither the balance sheet nor the profit and loss account can fully clarify these issues. The synthesis calculation in which the cash flows and their formation methods are shown, and which comes to the support of users, is the cash flow statement.

## 5. Conclusions

In this article we have approached IFRS as a tool for reconciling the needs of financial analysis with the dynamics of the socio-economic and political environment, focusing on financial information as the basis of financial analysis. We highlight the following:

♦ Financial information in the modern economy has many meanings depending on the users. As the objectives pursued by the users of financial statements are different, the financial analysis will be carried out in different ways. In a functional economy, based on competition, it is important to maintain a balance between the needs of each category of users and not to focus only on a series of information specific to a certain category;

♦ The possession, manipulation and use of information can improve the cost-effectiveness ratio in many physical or cognitive processes;

♦ The usefulness of financial information represents a mixture of qualitative characteristics and generates added satisfaction for those who use it. Obtaining a true picture of the activity of any company depends on the quality of the information provided by the financial statements. Financial information is the basis for decision makers who need data whose benefits outweigh the costs of obtaining it, and specific characteristics to be validated.

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