Using the FASB’s Qualitative Characteristics in Accounting Policy Choices

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Financial accounting standard setting involves making choices among alternative accounting methods. Accounting methods are multidimensional in nature, and each has many attributes which may be relevant for making a choice. The latest attempt to articulate relevant attributes appears in Statement of Financial Accounting Concepts No. 2: Qualitative Characteristics of Accounting Information (FASB [1980]). Underlying this endeavor is the assumption that identifying and defining the appropriate attributes (qualitative characteristics) of accounting information will help standard setters in selecting financial accounting methods. The purpose of this study was to test this assumption for SFAC No.2 (hereafter, Statement).

A direct way to test the effectiveness of the Statement would be to assess the “quality” of standard setters’ judgements, before and after the statement. Unfortunately, we know of no operational ways to measure the quality of their decisions. We tested instead for what we believe are three necessary conditions for the Statement to facilitate standard setting. First, the qualitative characteristics should be operational. We assessed the operational status of the qualitative characteristics within a multi-trait-multimethod paradigm proposed by Campbell and Fiske [1959]. Second, the qualitative characteristics should be comprehensive in that they represent all factors important for making accounting policy choices. Third, there should be a minimum amount of overlap in meaning among the characteristics. Significant redundancies in meaning would suggest that a more parsimonious set of characteristics would serve policy makers equally well. These three criteria – sometimes called convergent validity, predictive validity, and discriminant validity – are frequently suggested in the social science literature for evaluating the usefulness of concepts, and the FASB has expressed concern about the degree to which their qualitative characteristics meet each of these criteria.

The FASB characteristics were tested in an experiment using former members of the APB and FASB. Our results suggest that two of the characteristics – verifiability and cost - are operational as defined in the statement, but not the others. In addition, while the qualitative characteristics appear to constitute a comprehensive set of attributes for accounting policy choices, the set is not parsimonious.