3. Objectives of Financial Reporting

Most organizations devote a fair amount of time and effort to considering their goals and objectives. These endeavors are often reduced to a mission statement and strategic plan. In a similar fashion, the Financial Accounting Standards Board spent years in developing a series of Statements of Financial Accounting Concepts (SFAC). These should not be confused with the many Statements of Financial Accounting Standards (SFAS) that provide specific accounting rules on various matters (e.g., how to calculate EPS, etc.). The SFAC are far more general and define the objectives of accounting, the qualities that make accounting information useful, and so forth. The FASB is the primary beneficiary of the SFAC, as the conceptual guidance is used in the development of specific accounting rules.

3.1 Objectives

SFAC No. 1 examined the objectives of financial accounting and reporting. It is a fairly lengthy document. Foremost among the objectives is to provide useful information for investors, creditors, analysts, government, and other financial statement users. Importantly, accounting information is general purpose and should be designed to serve the information needs of all types of interested parties. To be useful, information should be helpful in assessing the amounts, timing, and uncertainty of an organization's cash inflows and outflows; assist in the study of an enterprise's resources, claims against those resources, and changes in them; and, be helpful in examining an enterprise's financial performance (i.e., earnings and its components). Additionally, accounting should help decision makers monitor and evaluate how well management is fulfilling its stewardship responsibilities.

Of what value is accounting? Why is so much time and money spent on the development of accounting information? To fairly answer these questions, one must think broadly. Investors and creditors have limited resources and seek to place those resources where they will generate the best returns commensurate with the risks they are willing to take. Accounting information is the nexus of the decision-making process. When accounting fails to provide valuable signaling to help investors and creditors choose wisely, then capital can be misallocated (i.e., placed in the wrong endeavors). Misallocation of capital can result in inefficient production and shortages of critically needed goods and services, causing severe economic disruption. Although it is difficult to fully comprehend, at least consider that when you go to the store with the expectation of acquiring certain items, they are usually there; investors and creditors provided capital to get those goods in place for you. And, the decision-making process for those investors and creditors was driven by accounting information! So, when we say that the objective of accounting is to provide useful information for investment and credit decision making, the implications are much broader than just helping investors and creditors make their profit. There is a broader societal role for accounting that has to do with enabling capital flows in a way that facilitates the production of desired goods and services.