



**THE PERCEPTIONS OF INDONESIAN ISLAMIC
COMMERCIAL BANKERS AND DEPOSITORS ON THE
QUALITATIVE CHARACTERISTICS OF FINANCIAL
REPORTING**

BY

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the degree of Master of Science (Accounting)**

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ABSTRACT

This study aims to ensure the effectiveness and quality of the financial reporting of the Islamic Indonesian Banking by operationalising the qualitative characteristics of the financial reporting. The assessing used five factors which are understandability, relevancy, timeliness, comparability, and completeness and faithfulness information factor to cover the criteria. The researcher used questionnaire since it is the best choice due to achieve the research objective of the study and to prove either to accept or reject the six hypotheses from seeking the respondents' opinions as the target is bankers and depositors. The research results show that the qualitative characteristics financial reporting reflected by average significant 0.511. Hence, all of the hypotheses are accepted because of both bankers and depositors agreed that the qualitative characteristics of financial reporting could help the understanding level of the user and at the same time it keeps the effectiveness and quality of financial reporting. This is important because since considering not all the users would be able to understand the financial report. However, there must be improvement for future research based on this issue such as the various participants with large number, extending the number of questions that could make more cover detail the criteria and adding the relative of theory such as agency theory.

خلاصة البحث

هذه الدراسة تهدف إلى ضمان فعالية وجودة القوائم المالية للمصارف الإسلامية الإندونيسية عن طريق الخصائص النوعية للقوائم المالية. قامت الدراسة باستخدام خمسة عوامل للتقييم و تغطية المعايير وهى الفهم، والملائمة، والتوقيت، والمقارنة، والاكتمال، والثقة بالمعلومات. استخدم الباحث الاستبيان لأنه هو الخيار الافضل نظراً لتحقيق الهدف من الدراسة البحثية ولإثبات قبول أو رفض الفرضيات الستة عن طريق التماس آراء المستجيبين، وهما المصرفيين و المؤدعين. تظهر نتائج البحث أن الخصائص النوعية للقوائم المالية انعكست باهمية متوسطة "0.511". وبالتالي، ثم قبول كل الفرضيات لأن كل من المصرفيين والمودعين وافقوا على أن الخصائص النوعية للقوائم المالية يمكن أن تساعد المستخدم على فهم مستوى المعلومات وفي الوقت نفسه تحافظ على فعالية وجودة القوائم المالية. هذا مهم جداً لأنه بعد النظر أن كافة المستخدمين لا يستطيعون فهم القوائم المالية. من ناحية أخرى يجب أن يكون هناك تطور للبحث في المستقبل على هذه المسألة، حيث يمكن استخدام عدد كبير من المشاركين أو زيادة عدد الأسئلة، التي يمكن أن تجعل أكثر تفصيلاً من ناحية الغطاء للمعايير و إضافة نظرية ملائمة مثل نظرية الوكالة.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

Siti Normala Seikh Obid
Supervisor

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Name: KHALIK PRATAMA

Signature_____

Date_____

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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*To My Beloved Parents, Ramayulis Nst and Hasrita Lubis
With Highest Gratitude for their Pray and Support
Jazakumallah Khairaljaze . Rabe iqfirli wa li-walidayya
wa irham hume kame rabbaene Iagira.*

*Thank to my brother and sister, Ikbar Pratama and Arifa Pratami,
Who always encourage and support me to complete my work*

*And thanks to my beloved fiancée, Rani Irmaliani,
Who always reminds, shares, and pushes me to seal the job*

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TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page	iv
Declaration	v
Copyright Page	vi
Dedication	vii
Acknowledgments	viii
List of Tables	xii
CHAPTER ONE: INTRODUCTION	1
1.1 Introduction	1
1.2 Background of Study	1
1.3 Problem Statements	3
1.4 Motivation of the Study	3
1.5 Research Objectives	4
1.6 Research Questions	5
1.7 Research Significance	6
1.8 Limitations of the Study	6
1.9 Structure of the Thesis	7
1.10 Conclusion	8
CHAPTER TWO: LITERATURE REVIEW	9
2.1 Introduction	9
2.2 Financial Reporting	9
2.3 The Objectives of Financial Reporting	10
2.4 Characteristics of Qualitative Financial Reporting	12
2.4.1 Relevance	13
2.4.2 Understandability	14
2.4.3 Materiality	15
2.4.4 Timeliness	16
2.4.5 Reliability and Faithful Representation	17
2.4.6 Completeness	18
2.4.7 Comparability	18
2.5 Previous Research on the Qualitative Characteristics of Financial Reporting	19
2.6 Conclusion	20
CHAPTER THREE: RESEARCH METHODOLOGY	22
3.1 Introduction	22
3.2 Research Methods	22
3.3 Research Instrument (Questionnaire Model)	24
3.3.1 Questionnaire Development	26
3.3.1.1 Dimension of Respondent Demography (Section I)	26

3.3.1.2 Dimensions of Financial Reporting Criteria (Section II)	26
3.3.1.3 The Wording and Sequence of the Questionnaire	27
3.3.1.4 Scaling Procedure	28
3.3.1.5 Physical Characteristics of the Questionnaire	28
3.3.2 Pilot Test	29
3.3.3 Translation	30
3.4 Sample Selections and Questionnaire Distribution	31
3.4.1 Bankers.....	31
3.4.2 Depositors	32
3.4.3 Questionnaire Distribution	33
3.5 Data Collection Procedure	33
3.5.1 The Overall Response Rate.....	34
3.6 Data Analysis (Statistical Test)	35
3.7 The Reliability Test and Validity Test.....	36
3.7.1 Reliability Test.....	37
3.7.2 Validity Test.....	37
3.8 Conclusion	38
CHAPTER FOUR: FINDING AND ANALYSIS	39
4.1 Introduction.....	39
4.2 Non-Response Bias Test.....	39
4.3 Reliability Test.....	40
4.4 Normality Test	41
4.5 Demographic of Respondents.....	42
4.4.1 Gender	43
4.4.2 Group Age	43
4.4.3 Education Background	44
4.4.4 Job Position and Occupation Types.....	45
4.4.5 Working Experience and Period Time	46
4.6 Data Analysis and Findings	48
4.7 Conclusion	53
CHAPTER FIVE: SUMMARY AND CONCLUSION	54
5.1 Introduction.....	54
5.2. Summary of the Implications of the Research Findings.....	54
5.2.1 The Implication of the Results of the Qualitative Characteristics of Financial Reporting.....	54
5.2.2 The Implication of the Results of Understandability Factor.....	55
5.2.3 The Implication of the Results of Relevance Factor.....	55
5.2.4 The Implications of the Results of the Timeliness Factor	55
5.2.5 The Implications of the Results of Comparability Factor.....	56
5.2.6 The Implications of the Results of Completeness and Faithfulness Factor	56
5.3 Comparison on the Results of Qualitative Characteristics Financial Reporting Studies.....	56
5.4 Limitations of the Study	58
5.5 Recommendations.....	59
5.6 Future Research	59

5.7 Conclusion	60
BIBLIOGRAPHY	61
APPENDIX A: PERMISSION LETTER TO COMPANY	67
APPENDIX B: LETTER FROM THE COMPANY	68
APPENDIX C: SURVEY QUESTIONNAIRE FOR BANKER.....	69
APPENDIX D: SURVEY QUESTIONNAIRE FOR DEPOSITOR.....	71
APPENDIX E: TRANSLATION OF SURVEY QUESTIONNAIRE FOR BANKER	73
APPENDIX F: TRANSLATION OF SURVEY QUESTIONNAIRE DEPOSITOR.....	75

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
3.1	Subjects Covered in Different Sections of the Questionnaire.	25
3.2	Banker Group.	33
3.3	Depositor Group.	33
3.4	The Questionnaire Distribution and Response Rate.	35
4.1	Non-Response Bias Test on Characteristics of Financial Reporting.	39
4.2	The Reliability Test on the Criteria of Financial Reporting.	40
4.3	The Normality Test on the Characteristics of Financial Reporting.	41
4.4	The Gender Frequency.	42
4.5	The Age Frequency.	43
4.6	The Education Background Frequency.	44
4.7	The Job Position and Occupation Types Frequency.	45
4.8	The Working Experience and Period Time Frequency.	46
4.9	The Mean of Qualitative Characteristics Financial Reporting.	48
4.10	The Ranking of Qualitative Characteristics Financial Reporting.	51
4.11	The Significant Level of Qualitative Characteristics Financial Reporting.	52

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

This chapter details the overall structure of the research with the aim of providing a systematic account of the various steps and methods adopted to achieve the research objectives of this research. Following section 1.1, the background of study is explained in section 1.2. Sections 1.3 and 1.4 articulate the problem statement and motivations inspiring this research. Sections 1.5 and 1.6 state the research objectives and research questions, while section 1.7 argues the originality of the research and the expected outcomes. Section 1.8 frames the research by identifying its limitations, while section 1.9 graphically illustrates the various steps of the research as embodied in each chapter. Section 1.10 concludes this introductory chapter.

1.2 BACKGROUND OF STUDY

Financial reporting is essential to keep proper records of assets, liabilities and transactions of any corporate entity. It offers an important description and background to the financial standing of any corporate entity. Given differences in business, different kinds of financial reports are prepared by different kinds of entities for different uses and users.

The determination of whether an entity's financial reports are effective is driven by the needs of the users of those reports. The users of such report varies widely in the types of decisions they make, as well as the methods and information they use in their decision process. The financial information in the reports must be

presented in a manner that is understandable to a wide variety of users. In addition, it is useful if the manner in which such information is presented is standardised across industries or sectors.

Such standardisation makes comparability possible, which in turn, allows decision makers to identify similarities and differences in information between organisations, which have not been obscured by differences in accounting practices. This leads to the need for a standard approach to presenting financial reports. According to IASB (2007), accounting information has to be useful for decision-making purposes. Understanding the characteristics of accounting information has great value for an estimation of the contents of the financial reports.

Knowledge of the restrictions inherent in the accounting information helps objectively perceive the economic information presented in the reports. Hence, maintains standards of quality in financial reporting is necessary to understand an entity's ability to satisfy established and prospective information requirements. The banking sector is an integral part of a nation's economy with a vast number of potential investors, creditors and other stakeholders, all of whom depend on financial reports for their decisions.

For this reason, along with their general knowledge of accounting, the researcher selected bankers as the sample population for this study. Furthermore, in order to strike a balance in interests, the opinions of bankers are compared with those of depositors most of whom do not have a basic knowledge of accounting. Further, the Indonesian Islamic Commercial Banking (ICB) industry is the subject, considering that ICBs have swiftly established themselves in all parts of the financial world.

This study will help measure the quality of financial reports of the Indonesian Islamic banking sector by examining the qualitative characteristics of accounting information.

1.3 PROBLEM STATEMENTS

Financial reporting seeks to provide financial information about the reporting entity which is useful for potential investors, lenders and other creditors in order to help them make investment, credit and other decisions (IASB, 2007). In order to achieve such objectives, the IASB (International Accounting Standard Board) identifies the qualitative characteristics of accounting information which facilitates improved decision making (Kieso, et al., 2011). To provide complete information, companies prepare general-purpose financial reports. These reports provide useful information however, users must have basic knowledge of business and financial accounting matters in order to understand the information contained therein. Such reports assume a level of competence on the part of users. This assumption impacts the way and the extent to which companies report information (Kieso, et al., 2009). In light of this, this study aims to assess the simplicity and effectiveness of financial reporting by incorporating the qualitative characteristics of understandability, relevancy, timeliness, comparability, and completeness and faithfulness to assist users make good economic decisions.

1.4 MOTIVATION OF THE STUDY

This study is motivated by the evidence suggesting that financial reports are hard to understand, especially in Indonesia. It is argued that adopting the aforementioned qualitative characteristics in the preparation of financial reports will ease and help

users better understand such reports. Secondly, although there are many articles that have discussed issues in financial reporting, few have focused on its qualitative characteristics, especially in Indonesia. Last but not least, financial reporting is becoming increasingly complicated since complying to IFRS. Although some companies are yet to comply, they must do soon. Furthermore, many are yet to properly understand the requirements and implications of such new regulations. Examining the efficacy of qualitative characteristics of financial reporting helps test the quality of the current regulations. With this in mind, this research is set to offer policy makers and regulators important insights for policy development.

1.5 RESEARCH OBJECTIVES

This research seeks fill the aforementioned lacuna in the literature by attempting to be among the first thorough studies of the qualitative characteristics of financial reporting in Indonesia. To this end, the following research objectives are targeted.

RO: To investigate the perceptions of Indonesian Islamic Commercial Bankers and depositors about the qualitative characteristics of financial reporting.

RO1a: To investigate the perceptions of Indonesian Islamic Commercial Bankers and depositors concerning the understandability of financial reporting.

RO1b: To investigate the perceptions of Indonesian Islamic Commercial Bankers and Depositors concerning the relevancy of financial reporting.

RO1c: To investigate the perceptions of Indonesian Islamic Commercial Bankers and depositors concerning the timeliness of financial reporting.

RO1d: To investigate the perceptions of Indonesian Islamic Commercial Bankers and depositors concerning the comparability of financial reporting.

RO1e: To investigate the perceptions of Indonesian Islamic Commercial Bankers and depositors concerning the completeness and faithfulness of financial reporting.

1.6 RESEARCH QUESTIONS

In order to achieve the aforementioned objectives, the following research questions are formulated:

RQ: Are there different perceptions between Indonesian Islamic Bankers and depositors regarding the qualitative characteristics of financial reporting?

Rq1a: Are there different perceptions between Indonesian Islamic Commercial Bankers and depositors concerning the understandability of financial reporting?

Rq1b: Are there different perceptions between Indonesian Islamic Commercial Bankers and Depositors concerning the relevancy of financial reporting?

Rq1c: Are there different perceptions between Indonesian Islamic Commercial Bankers and depositors concerning the timeliness of financial reporting?

Rq1d: Are there different perceptions between Indonesian Islamic Commercial Bankers and depositors concerning the comparability of financial reporting?

Rq1e: Are there different perceptions between Indonesian Islamic Commercial Bankers and depositors concerning the completeness and faithfulness of financial reporting?

1.7 RESEARCH SIGNIFICANCE

The significance of this research manifests in its contribution to academic literature and practices. The study of qualitative characteristics of financial reporting remains new in the context of Indonesia. It is hoped that this study will attract other researchers to continue and improve on this study especially Indonesian scholars. Secondly, the results of this study have the potential better establish and evaluate the financial reporting standards, particularly by relating the findings to the specific statements in Indonesian financial reporting acts. This is particularly relevant to regulators and policy makers. Correspondingly, it is expected that this research will assist in rendering financial reports more understandable, especially by third party users.

1.8 LIMITATIONS OF THE STUDY

The limitations of the study are:

- a. The translation of the questionnaire from English to Indonesian might not represent the true meaning of the questions.
- b. Given the rarity of the topic, it is difficult to make comparisons due to the lack of empirical study in this area.

- c. The number of participants is small. The sample consisted of 210 bankers and 110 depositors. Furthermore, the respondents were all from one state (Jakarta). A much larger sample from all states in Indonesia is needed for more generalisable results.
- d. Time constraints meant little time for distributing and collecting the data.

1.9 STRUCTURE OF THE THESIS

The thesis is organised into five chapters. Briefly, the first two chapters discuss the background of the study and the literature review. The next chapter explains the research methodology adopted by the study. The last two chapters discuss the findings of the study and conclude the research with a number of recommendations.

Chapter One: Introduction

This chapter presents a brief overview of the background of the study, statement of the problems, research objectives and research questions, purposes of the study, the research motivations and significance of the study, limitations of the study, and the structure of the thesis.

Chapter Two: Literature Review

This chapter reviews and focuses on literature concerning the qualitative characteristics of financial reporting. It also explains the theoretical foundations of the study, agency theory for financial reporting, along with the research hypotheses.

Chapters Three: Research Methodology

Chapter three explains the research methodology. It identifies the elements of the research framework and delineates the steps undertaken in relation to developing the study instruments, pilot study, and data collection approaches.

Chapter Four: Finding and Analysis

Descriptive statistics are used to summarise the data. Statistical testing methods such as paired sample T-test, and Mann-Whitney U test, correlation, and regression are utilised in the study.

Chapter Five: Conclusion, Challenges, and Contribution

The results of the study are discussed further in terms of its implications in this chapter, and conclusions of the findings are carefully elaborated.

1.10 CONCLUSION

This chapter briefly described the blueprint of this thesis. It described the master plan of this study and the targeted objectives. The following chapter provides information about the literature review relevant to this study.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter discusses financial reporting, the theoretical framework, and hypotheses development. Reviewing the literature improves the researcher's understanding about the issues at hand in addition to learning about methods applied in previous studies. Following the introduction, section 2.2 begins by discussing financial reporting. Section 2.3 discusses the objective of financial reporting. Furthermore, section 2.4 reveals the qualitative characteristics of financial reporting, while section 2.5 review previous studies on the qualitative characteristics of financial reporting. Section 2.6 concludes the chapter.

2.2 FINANCIAL REPORTING

The information obtained in financial reporting is considered highly important for the decision-making process. Therefore, such information gains a respectable amount of value to different users. As the decision-making process is a critical issue, the quality of this process depends to a great extent on the reliability and validity of the information. As the decision process is becoming more complicated, completeness and assurance of information are vital characteristics that are reflected in the reliability and validity of this sort of information.

2.3 THE OBJECTIVES OF FINANCIAL REPORTING

There are many reasons why companies should publish their financial reports. One of them is because the financial statements of a company are a valuable economic decision-making tool for users and therefore the financial statements contribute to the well-functioning of the capital markets (Hoogendoorn & Mertens, 2001). According to the Framework for the Preparation and Presentation of Financial Statements of the International Accounting Standards Board (IASB), the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions (IASB, 2005).

The development of the objectives of financial statements was a long and arduous process due to constant debates over the objectives of financial reporting since the publication of the Trueblood Committee report in 1973 (Chang & Most, 1985). Wolk et al. (1992) argued that the document is, to a large extent, justly accused of being all things to all people. However, in spite of these limitations, this statement was a step toward the development of financial accounting and has directly influenced both the Trueblood Report and the Corporate Report in their search for the objectives of financial statements. The Trueblood Report (AICPA, 1973) reached a number of conclusions on the desirable goals of the financial accounting process:

- a. The basic objective of financial statements is to provide information useful for making economic decisions.
- b. An objective of financial statements is to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.

- c. An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.
- d. An objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earning power.
- e. An objective of financial statements is to supply information useful to judging management's ability to utilise enterprise resources effectively in achieving the primary enterprise goal.
- f. An objective of financial statements is to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.
- g. An objective of financial statements is to report on those activities of enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment.

Since then, studies on the objectives of financial reporting, like the Trueblood Report in the US and the Corporate Report in the UK, explicitly considered that the primary objective of financial accounting should be to aid users in making their decisions (Ryan et al., 2002). The literatures have seen extensive studies of the users' needs in the financial reports of the corporations particularly focusing on decision usefulness as the primary purpose of financial reporting.

Preparers, standard setters, and users agreed that the primary purpose of external financial reporting is to provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources (AASB, 2001).

Notably, the Trueblood Committee report stated that the objective of financial reporting is to provide information useful for making economic decisions. The propositions were then used by the American Accounting Association (AAA) and the Financial Accounting Standards Board which endorsed the concept that financial statements should provide information that is useful to present to potential investors and creditors in making rational investment and credit decisions (FASB, 1978).

Thus, the development of financial reporting evolved around the major aim of producing information that will satisfy varieties of different user groups and the need for useful information (Lee, 1988). The framework also describes what qualitative characteristics information should possess in order to be useful, such as understandability, relevance, reliability and comparability. The next sub section sets to explain these characteristics in greater detail.

2.4 CHARACTERISTICS OF QUALITATIVE FINANCIAL REPORTING

The qualitative characteristics are derived from the International Accounting Standards Board (IASB) framework. It can be said that the qualitative characteristics, as a hierarchy of qualities, makes the information in the financial reports useful for users. Therefore, lack of financial reporting elements would be assumed to have a negative impact on the quality on the financial reporting itself. Hendriksen & Van Breda (1992) defined qualitative characteristics as attributes of accounting information which tend to enhance its usefulness. Thus, according to the conceptual framework of the IASB (2001), the qualitative characteristics of financial statements (relevant to this study) are: (I) Relevance, (II) Understandability, (III) Materiality, (IV) Timeliness, (V) Reliability, and Faithful Representation, (VI) Completeness and, (VII) Comparability.