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Fair value Accounting between the Advocacy and Opposition

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Abstract

The conceptual framework of the financial reporting for 2018 clearly indicates fair value as one of the alternatives to the accounting measurement in paragraphs (6-12) and from (12-16) as one of the foundations of the accounting measurement. The increased interest in fair value is due to the unrelenting efforts that coincided with the efforts of (IASB) International Accounting Standard Board and (FASB) Financial Accounting Standard Board through joint action to issue standards, interpretations and clarifications regarding fair value measurement. Through the adoption of (IASB) the standard issued by (FASB) No. (157) in 2006 regarding the fair value as a draft for discussion in 2009, the approaches adopted in the measurement of financial and non-financial assets and liabilities were discussed. These discussions sought to focus on the importance of adopting the fair value because of the information it provides to stakeholders, so that accountants reach a convergence in the issuance of IFRS13 (fair value measurement) in 2011. However, there are conflicting professional and academic attitudes and research trends regarding the adoption of fair value. The article aims to review the two directions of analysis, interpretation and criticism by reviewing some of the studies that are concerned with the topic. The results show that the fair value is an important measurement basis that matches the requirements of stakeholders.

Keywords- Fair Value, Fair value accounting, FASB, Financial reporting, IFRS.

1. Introduction

The adoption of fair value as a method of accounting measurement will lead to fundamental changes in the environment of accounting practices, and accordingly, the controversy has increased regarding adoption and adoption. As well as the controversy between supporters of fair value as it is more appropriate to make decisions and opponents who link the fair value and financial crises and profit management. Besides, the problem of measuring the fair value of non-financial assets, the difficulty of verifying prices, and incurring high costs to achieve this are emerging. Accordingly, the article will be reviewed through two aspects, the first aspects includes the trend in favor of adopting the fair value, while the second aspect represents the tendency opposing the adoption of the fair value. Finally, the most important conclusions and recommendations for future research are reviewed.

2. Literature Review

2.1 Advocacy of fair value in accounting measurement

In the direction of advocacy of fair value, many studies believe that fair value information is more relevant for making decisions compared to what historical costs provide. Alexander, Bonaci, and Mustata (2012) tested the adoption of fair value in the financial reports of Romanian companies, so the research found that the adoption of fair value is best suited to its approval in the active market. Moreover, the inactive markets when adopting the fair value present practical problems because they rely on models of measurement based on personal judgment. We believe that this is not a criticism, given that the measurement in accounting has an aspect that depends on personal judgment. The figures in accounting are not with real numbers that must be taken as they are. With regard to the validity of the term fair value as being fair and do they deserve to be framed with justice, Sundgren (2013) reviews both the opposing and pro-fair approaches to conclude that the fair value is a fair right if it is accompanied by high-quality terms of reference because it provides important information to stakeholders. For example, investors who can predict the ability of the economic unit to generate cash flows from assets as well as provide indicators of importance regarding the uncertainty accompanying future cash flows. Numerous studies have demonstrated the benefits and benefits associated with adopting fair value such as (Laux & Leuz, 2009), (Caskey & Hughes, 2011), (Badia, Duro, Penalva, & Ryan, 2017), (Badia et al., 2017), (Diana, 2015), (Collins & Dent, 1979), (Marsh & Fischer, 2013). Fair value is more appropriate to the needs of users of financial reporting and is reflected in decision making. In addition, it provides transparency in financial reports, increases their confidence in financial reports, and assists financial analysts by providing the information necessary to calculate ratios and indicators. Taking into account the purchasing power of the monetary unit when measuring at fair value gives better indicators of the true value of the economic unit because it is directly related to the concept of maintaining the in-kind capital of economic units and leads to a reduction in agency costs.

2.2 Opposition of fair value in accounting measurement

The opposite research trends and opposition to the application of fair value have linked the application of fair value to the global financial crisis. Many are against the application of fair value accounting standards because the application of fair value accounting, as they justify, contributes to unjustified amplification of real estate values. Consequently, it exaggerates the mortgage loans granted by the banks that led to the financial crisis. The response to this trend came from the US Securities Regulatory and Trading Commission that the fair value was not the cause of the crisis and attributed the reason to the incorrect conditions that accompanied the granting of loans. In October 2008, the US Congress asked the US Securities Regulatory and Trading Commission to discover if fair value was the cause of the financial crisis. Accordingly, it undertook exploratory procedures, which consisted of examining a sample of 55 financial institutions that had achieved financial failure. They concluded that fair value accounting was not the main or root cause of the financial crisis, given that the banks that failed had a small number of assets affected by fair value losses. In addition, the study concluded that the US Congress took incorrect measures regarding the request of the Financial Accounting Standards Board to suspend the application of SFAS No. (157), Fair Value Measurements .

Palea and Maino (2013) examine whether the fair value can easily generate tampering by opportunistic managers and that the accounting measurement and disclosure according to the fair value has generated additional accounting problems. The clearest evidence of this is the collapse of Enron, which relied on estimates for the second and third levels of the fair value hierarchies. We believe that other valuation methods other than fair value can check errors and reflected on the financial reports. The changes in the value of assets are the result of fluctuations in asset prices in the economic environment and cannot be attributed to accountability. Moreover, the estimate or personal judgment is accompanied by error as a result of reliance on probability. In another direction, the following question may come to mind:

Is the fair value in the financial reports as an appropriate accounting method for measurement in all environments to protect the investor and provide information?

Siekkinen (2016) He explained that the fair value is the best way to make decisions contrary to (historical cost) and that environments that have strong protection for the investor are characterized by a relationship between the relevance of accounting information and the quality of profits in financial reports. In these environments, there is strong

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protection for the investor from the opportunistic behavior of managers in terms of fair value. Whereas in environments that give weak investor freedom, there are strong incentives for managers to take opportunistic behavior to increase their wealth at the expense of shareholders. Managers manipulate fair value estimates and accordingly result in the risk of accounting information. Moreover, in strong investor environments, corporate governance is restricted to the manipulative behavior of managers. It was concluded that the environments with strong protection for the investor are the best in applying fair value due to the high control accompanying the investor protection.

3. Conclusion

The conceptual framework for financial reporting for 2018 clearly affirms that fair value is one of the bases of accounting measurement after long periods of controversy, research and comments by professionals, academics and interested parties. The fair value is one of the methods of accounting measurement that has been criticized, the most prominent of which is that it has generated the public financial crisis. However, the companies that failed have had a small number of assets that were affected by the losses of the fair value, and accordingly, the fair value was not the main cause of the real estate financial crisis. In addition, valuation approaches other than fair value can make mistakes and this will be reflected in the financial reports. Changes in the value of assets are the result of fluctuations in asset prices in the economic environment and cannot be attributed to fair value. Moreover, judgment or personal judgment is accompanied by error as a result of dependence on probability. We believe that the fair value is appropriate for stakeholders in making decisions because it takes into account the purchasing value of the currency unit. On this basis, they invite authors to pay attention to research currents that test the adoption of fair value in different environments and the benefits derived from them. In addition, the need to pay attention to the Iraqi environment and to reflect the adoption of fair value therein in the accounting and auditing professions.

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