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FAIR VALUE - ACCOUNTING CONCEPTS AND IMPLICATIONS

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Abstract
International financial reporting standards IFRS represent a new frontier for studies related to financial statements, practical a fundamental pillar to support the process of accounting financial harmonization at European and global level. In this context, in 2012, or rather 2013, if we consider the year of adoption, we would witness the introduction of a new international accounting standard, which aims to introduce an accounting accounting method, considered innovative in terms of valuing the elements of assets and balance sheet liabilities. In other words, the valuation of these items is no longer limited to the historical cost, this valuation process has become much more flexible by introducing the fair value criterion. This paradigm shift, together with the economic events that have taken place as a result of the current financial crisis, have given rise to new heated debates on the regulation of financial markets and the interventions needed to guarantee economic stability at the level of European companies and to standardize the structure of the components that make up the mandatory financial reporting. The objective of this paper is in this context, starting from the requirements imposed by the new IFRS 13, but also from the pros and cons of the non-academic environment and practitioners regarding the valuation of assets and liabilities in accordance with the fair value principle.

Key words: *fair value, IAS/IFRS, financial reporting, accounting policy*

JEL Classification: *M41*

I. INTRODUCTION

At present, accounting has come to occupy an increasingly relevant position in the functioning of modern economic societies. As a result of previous developments, accounting has become increasingly important, not only from an organizational point of view, but especially from a social point of view. This discipline is no longer perceived as a simple tool or set of calculation methodologies, but as an authoritarian and valid mechanism for economic and social management: in fact, we are currently witnessing a major change in the accounting culture, in the sense that when we refer to the financial statements we no longer refer only to their purely decisional purpose or to the importance they cover in the management of the business, but also to the contribution and the interest they show in satisfying the claims of stakeholders (Cosmulese, 2019).

Basically, we are witnessing a situation in which the economy has detached from a purely operational accounting vision, management has joined finance, international markets and capital movement, which has led to the perception of the globalization process as an indispensable phenomenon.

In this context, Europe has been forced by circumstances to fulfill a demanding institutional task, that of amending and revising accounting standards in favor of international financial reporting standards, known under the acronym IFRS. Faced with this, companies have committed to quickly adapt to the implementation and understanding of all existing regulations, this change having a significant impact not only on accounting issues, but also on other operational dimensions. In order to cover almost all the problems that could arise from the use of different accounting systems, the EC/1606/2002, issued on 19 July 2002 by the European Parliament and the Council, required Community companies whose securities were traded on public procurement to prepare their financial statements (initially only consolidated ones) in accordance with international accounting standards IAS 3 and IFRS4.

The ultimate goal that the European Community wanted to achieve through a gradual introduction of IAS/IFRS accounting standards was international convergence, so that European companies active in the financial markets are globally recognized. With these prospects for the integration of capital markets, the European Parliament and the Board have provided that entities that have prepared their consolidated financial statements in accordance with IAS / IFRS as of January 1st, 2005 or if their securities have been admitted to trading on a regulated market of any Member State, to prepare financial statements in accordance with the requirements of IFRS.

Therefore, it can be stated that the economic-financial communication was the main and most important tool for the reporting companies that operated and still operate on the financial markets, because the differences in

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the accounting language used could only be an obstacle in communication. In other words, we are witnessing a conformity of financial-accounting languages that has pushed the EU into the convergence process. However, we must not ignore the fact that, while on the one hand accounting harmonization and standardization have allowed easier access to accounting information by the global player, on the other hand, some issues remain open today, such as the criterion of valuation at fair value. The idea behind fair value is to give annual balance sheets greater objectivity, transparency and relevance. There are arguments for and against the whole concept of fair value. The biggest argument in its favor is that it allows for a more accurate balance sheet and one that better reflects the current value of assets and liabilities. The value of these assets and liabilities, in turn, reflects the business market and therefore provides a very up-to-date perspective on the current market situation.

II. WHY THE FAIR VALUE?

Everyone now knows that the accounting revolution that took place with the introduction of the IAS is due to fair value, but few still know what that term means. The proof is that the correct translation is "fair value", a term that has nothing to do with a conventional quantity, such as the fair value of the IAS. The most accurate translation of fair value, as used by the international accounting standard, is "conventional current value".

In fact, the major changes brought by IAS/IFRS consisted in expressing the financial statements at current values, to the detriment of historical costs. But it is fair to point out that these values are largely subjective. For this reason, it is not possible to understand the magnitude of this accounting revolution without understanding what the IAS/IFRS rules refer to when referring to fair value (Guatri & Bini, 2004).

The concept of fair value, as reported in Directive 2001/65 / EC43 of the European Parliament and of the Council, approved on 27 September 2001, amending Directives 78/660 / EEC 44, 83/349 / EEC 45 and 86 / 635 / EEC 46, as regards the accounting discipline for the preparation of the annual financial statements (and consolidated financial statements) of certain types of entities, as well as of banking and financial institutions, is determined by recourse to two different concepts, namely (see Fortunato , 2007; and https://www.fiscoetasse.com):

- The market value that applies to all those financial instruments for which there is a regulated market and is easy to identify; alternatively, reference is made to the market value of identical and similar instruments if the market value of the financial instrument under consideration is not easily identifiable;
- The value obtained from pre-established models or from a conventionally accepted valuation, for financial instruments for which there is no regulated market or which cannot be easily identified.

Currently, unlike what the Romanian legislation elaborated in accordance with the European Directives in 2005, we have presented the notion of fair value within OMFP 1802/2014 (point 106-paragraph (3), p.15), which comes with a slightly modified definition compared to OMFP 3055/2009, and this is as follows: “fair value is the price that would be received for the sale of an asset in a regulated transaction on the primary market (if any) or the most advantageous one, at the evaluation date, in the current market conditions (i.e. an exit price), whether or not that price is directly observable or is estimated using another evaluation technique”.

Today it is possible to say that this value is a real hybrid value, interposing between the current value and the market value, without coinciding with either. As a result, many researchers believe that the fair value criterion may introduce greater subjectivity into the preparation of financial statements and therefore lead to greater volatility in income results due to the recognition of unrealized costs and / or non-performing income was still made.

In order to solve these problems, the IASB analyzed and updated its conceptual framework. The IASB's effort can be seen in the interventions that took place on the conceptual framework, a document that clarifies how the evaluation of balance sheet items can derive from various processes used in determining balance sheet items and the profit and loss account. It can be seen, in fact, that in all evaluation processes, the assignment of a value consequently implies the choice of a certain evaluation criterion, considered, depending on the case, more or less appropriate. There are four evaluation methods present in the framework, namely: historical cost; current cost; realizable value and present value. The concept of fair value from the IFRS perspective is interpreted as “the amount at which an asset can be traded or a debt settled, between interested parties and knowingly, in a transaction carried out under objective conditions” (IAS / IFRS, 2015).

In practice, the IASB introduces fair value as a basis for evaluation, in 1998 for the first time, at the same time as standards: IAS 32 - Financial Instruments: Presentation and Description and IAS 39 - Financial Instruments: Recognition and Evaluation. However, the complex way of evaluating the fair value of financial instruments has the consequence, especially at European level, of not applying the standards mentioned by European companies applying IFRS (Regulation 1606/2002/EC). The following are other standards that use fair value for measurement: IAS 16 – Tangible assets (to replace the market value used to determine the value of the asset as a result of revaluation), IAS 40 – Real estate investments and IAS 41 - Agriculture in 2000, IFRS 5 - Fixed

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assets held for sale and discontinued operations in 2004 and IFRS 6 - Exploration and evaluation of mineral resources in 2005 (Jianu & Jianu, 2009: 82).

If we were to analyze the historical cost method (the valuation criterion used to prepare the financial statements in accordance with national accounting regulations, which meets the need for certainty) we can see how in the case of assets, it refers to a monetary amount, i.e. a cost paid for the acquisition of the asset in question, while in the case of liabilities, they are accounted for by identifying either the amount of money received by the entity in response to the obligations assumed or by determining the amount of money needed to settle the debt under normal operating conditions. However, this valuation method is gradually being replaced by the fair value method, which, in turn, aims to encourage a more dynamic reading of entities' performance (Cosmulese, Mateș & Anisie, 2016).

In this context, it is fair to remember that fair value does not completely overlap with any of the four criteria mentioned in the framework, although it may coincide with each of them, but only the importance of fair value is recognized as a substitute criterion for cost, practically for all factors of production for which the purchase is not proven by an outflow of money.

The analysis of the IASB framework will serve to have an overview of all the concepts underlying the preparation and presentation of accounting documents prepared in accordance with the IAS/IFRS principles. The main purpose of the framework is, in fact, to support the IASB in identifying concepts that will be used consistently throughout the development and revision of IFRSs. With the application of international accounting standards, the IASB determines which assets and liabilities are measured at fair value, as well as income and costs for the period, as well as any plus or minus value that contributes to the definition of the result for the year.

This was also the reason why we consider that the analysis of one of the most debated standards is important and justified, namely the one regarding the criteria for measuring and evaluating the fair value, focusing more on determining the value for assets and liabilities, and on the 3 hierarchical levels provided by the measurement of fair value for their identification and classification in accordance with IFRS 13.

III. FAIR VALUE ACCOUNTING, ADVANTAGES AND DISADVANTAGES

In practice, the accounting of assets and liabilities at fair value is based on market values, contrary to what happens in the national accounting system, which usually strictly respects the historical cost criterion (Cosmulese, 2019). In this regard, there are many international accounting standards that have provided a definition of fair value, with the aim of measuring, valuing and recognizing them. An initial definition of fair value (in accordance with the one found in FAS 157 issued by the US Board) is found in Chapter A, "Defined Terms", of IFRS 1: "The amount for which an asset could be exchanged, a liability settled, between knowledgeable, willing parties in an arm's length transaction". In accordance with IFRS 7, disclosures are required to disclose information about the importance of financial instruments to an entity, such as the nature and extent of the risks arising from such financial instruments, both in qualitative and quantitative terms. Specific disclosures are needed regarding the transferred financial assets and a number of other issues. IFRS 7 was originally issued in August 2005 and applies to annual periods beginning on or after 1st of January 2007.

The standard requires that financial assets measured at fair value through profit or loss be shown separately those held for trading, and those designated at initial recognition (investments) to be held to maturity (loans and receivables, available-for-sale assets, liabilities), financial statements at fair value through profit or loss), indicating separately those held for trading and those designated at initial recognition (financial liabilities measured at amortized cost).

The amendment to IFRS 7, issued in October 2008, states that the standard provides for the inclusion of disclosure requirements related to recent unauthorized reclassification of financial assets (other than those designated at fair value through profit or loss). Furthermore, the amendment issued in November 2008 clarified the effective date and the transitional date of the requirements. The third amendment to IFRS 7, issued in March 2009, addresses the request and provides consolidated information on fair value measurement and liquidity risk when providing useful information to users. The last change to this standard took place in 2014 and is applicable from 1 January 2016. This refers to service contracts, in particular additional guidance is added to clarify whether a service contract continues to be involved in a service contract assets transferred for the purpose of determining the required information, and further clarifies the applicability of the amendments to IFRS 7 on the interim financial statements.

Instead, IAS 21 *The Effects of Changes in Foreign Exchange Rates* (see https://www.iasplus.com/en/standards/ias/ias21) presented us with a difference in the wording of the definition of fair value, which, although minor, compared to the previous standards that provided for the conditional use of the verb could, as an alternative to the present indicative used in the definitions in the IAS / IFRS standards, namely: the asset could be exchanged or a debt could be extinguished, through a free transaction between the informed and

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independent parties. Also, IAS 32 Financial Instruments: Presentation also stood out through the full use of the definition of fair value, without even intervening through a minor change.

On the other hand, IAS 36 Impairment of Assets, when it came to the definition of fair value, in the context of asset depreciation, emphasizes that: fair value is the amount obtained from the sale of an asset or cash-generating unit in a free transaction, between informed and notified parties. It can be seen that since the standard refers exclusively to assets, the main difference from the other standards is found in the item being valued, in the sense that the definition of fair value does not refer to the company's debts. However, there is another important difference, namely, IAS 36 states that fair value is the amount that can be obtained (so there is only another consideration) for both assets and cash-generating units (CGU). An exclusive reference to assets was also found in IAS 38 Intangible Assets, according to which the fair value of an asset is the consideration at which it can be exchanged in a free transaction between the notified and informed parties.

Within IAS 16 Property, Plant and Equipment Adopted by EU Regulation no. 2238/2004, amended by EU Regulation no. 2236/2004, 211/2005 and 1910/2005) the definition of fair value represents the value of the consideration for which an asset can be exchanged or a debt extinguished, in a free transaction between informed parties and in full knowledge of the facts, together with which it also specifies the estimation criterion, in the sense that the fair value of land and buildings is usually represented by the usual market parameters, through an assessment which is normally carried out by professionally qualified experts.

The fair value of assets such as plant and equipment is usually represented by their market value determined through a valuation. In fact, it is inevitable to treat fair value in IAS 16, because due to the purpose and scope of this accounting rule, it is self-evident to provide a detailed definition of fair value. In other words, given that the role of IAS 16 is to provide accounting policies for tangible assets, it is necessary to use, even if indirectly, the fair value measurement criterion for this type of assets, a value that conforms to the logic approached in IAS 16 corresponds to the amount that would have been paid if that asset had been purchased or sold at that time. A similar definition for fair value is found in Petrolati (2002) which considers the concept of fair value as the consideration for which an asset is exchanged or a debt is settled, between approved parties and by mutual agreement, in a transaction between third parties.

Based on the above considerations, in May 2011, the IASB issued a specific accounting standard, called IFRS 13 Fair Value. This rule does not change the time or situation when a company is required to use fair value, instead it describes how to measure fair value where required or permitted (as indicated in the individual IAS or IFRS). The emergence of this standard was expected at the close of a process that began in 2006, which aimed to harmonize the related measurement and reporting rules, currently scattered across the various IAS/IFRS. The objective of this standard is to define fair value and to establish in a single IFRS a framework for measuring fair value. IFRS 13 applies when another IFRS provides or permits fair value measurements or disclosures (measurements, such as fair value minus the costs to sell, based on fair value or disclosures of those measurements).

First, with the adoption of this IFRS, the fair value concept is revised and clarified; fair value is defined as the price that, at the date of recognition, would have been obtained from the sale of an asset or should have been paid to settle a debt, in a normal transaction (i.e. a transaction between persons who are aware and are not obliged or compelled to carry out that transaction). On this occasion, it is clarified, once and for all, that fair value as defined for IFRS purposes is essentially an exit price and that advantages that are not available to other market participants should not be taken into account; but also that it is a price to be determined on the date of presentation. It also specifies that reference should be made to transactions taking place on the main market for a specific asset or liability or, failing that, that the most advantageous market should be considered, and in the case of non-financial assets, reference to the highest and best use for those assets.

With respect to methods of determining fair value, IFRS 13, although it does not prescribe certain valuation techniques to be used in different cases, nevertheless establishes that the fair value of an asset or liability must be determined by using an appropriate valuation technique in certain circumstances, referring to sufficient data and information to measure fair value, maximizing the use of observable data and information and minimizing the use of unobservable data and information. To this end, IFRS 13 establishes a hierarchy, divided into three levels, with reference to the reliability of the information used; the first level, i.e. the highest, is the one that includes quotations on active markets; the second, intermediate level is where fair value is determined by reference to quotations of similar assets and liabilities on active or inactive markets; the third level, which must be taken into account when no information is available on previous levels, refers to information that cannot be observed on the market or to the best alternative information available (see Figure 1). Of course, when establishing fair value, higher-level information should be preferred, if available (Vagnozzi, 2011).

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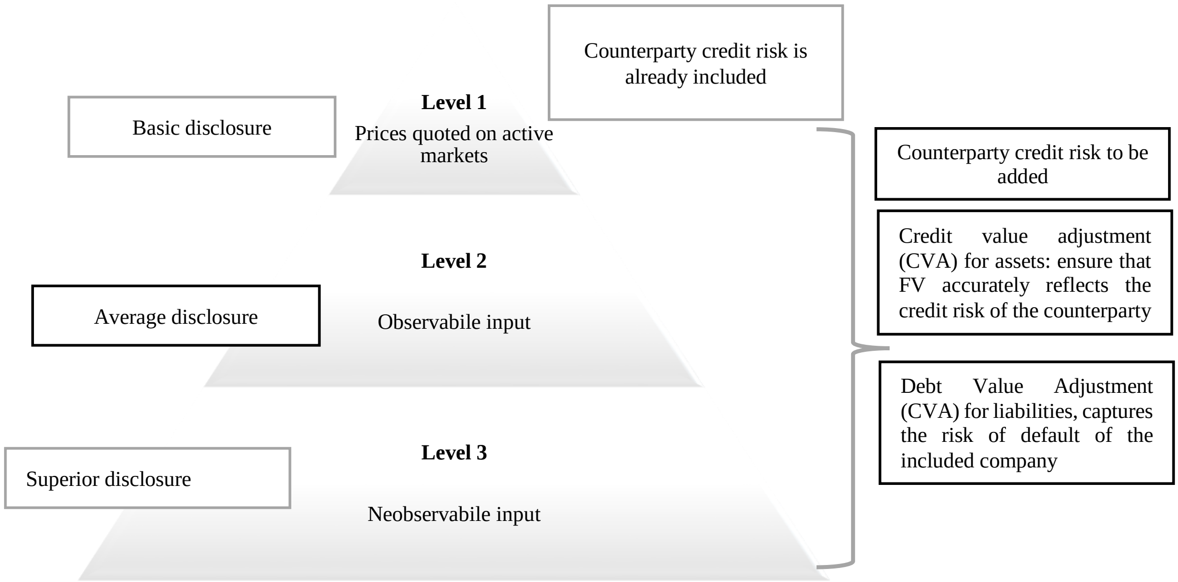

Figure 1 – Fair value hierarchy

Source: Author adaptation after Terazzi, 2013

The international standard IFRS 13 aims to increase coherence and comparability in the measurement of fair value related to disclosures through a fair value hierarchy, as mentioned above. This hierarchy gives the highest priority to prices quoted in the active markets for identical or passive assets and with the lowest priority for unobservable entries. The level of information used to determine fair value has a direct influence on the amount of information to be provided in the notes to the financial statements. The less observable the data (third level), the more information and explanations to be included in the notes to the financial statements.

However, we must emphasize that fair value is a market-based value that is not specific to the entity. To determine it, a series of measurement techniques are used in practice, the most important of which are (Terazzi, 2013): Market Approach (Quoted prices or other market information regarding identical or comparable instruments); Costing Approach (The amount needed to replace the ability to use a held asset, taking into account its depreciation); Income approach (option pricing models or current value techniques).

From a particular point of view, Bini & Guatri (2004) considered that it would have been better to refer to an average price (possibly weighted by the quantities traded, for a not short period of time), as fair value is a conventional quantity, this criterion being established by the IASB, and on the other hand the second category of fair value, represents an estimated value. We consider this approach to be very bold and original, as it is argued that fair value is not a completely fair measure, despite the fact that fair value does not refer to the real value of an asset, the authors believe that it is not fair to be related to the value related to the negotiations that take place on the market on the closing day of the financial statements.

IV. CONCLUSIONS

In conclusion, we can say that the concept of fair value approached by the standards presented above is starting to take more and more shape. We note that the IASB brings more and more additions regarding the definition of the term, the applicability of the legislation, the classifications, the recognition or impairment of assets that can be measured at fair value. Different conceptions and opinions appear, because more and more economists and accountants turn their attention to this concept, more or less with their will, these things being imposed by the national legislation in force.

Therefore, we can say that there is a conflict between two needs or requirements, on the one hand, the need for a balance sheet that, representing the conditions that reflect the specific economic reality of a reporting entity, favors current and potential investors, but at the same time is exposed to a significant discretion and volatility; on the other hand, however, the need for a balance sheet which, by adopting the historical cost as an evaluation criterion, guarantees verifiability and objectivity, but is not always able to represent the economic and financial potential of the reporting entity.

For these reasons, we believe that it was necessary to adopt a specific standard such as IFRS 13 to address issues that may arise when there is no observable market for debt or equity instruments. In fact, in these cases, the standard provides that it is still possible to observe a market, if it exists obviously, when these liabilities / equity

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instruments are held by third parties as assets. In this case, the ultimate goal of an economic entity should be to focus on maximizing the use of observable data, which is as relevant as possible, while reducing the use of unobservable or unnecessary data. In fact, only in this way will an entity be able to meet the requirements of fair value logic by estimating a market price in relation to the valuation date as well as current market conditions.

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