Roadmap for Convergence Regarding the Fair Value Concept

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Abstract. The new concept regarding harmonization or the convergence is concerning all together the professional organizations and the users of this concept of the faire value. The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) created a uniform outline for how to measure fair value for entities around the world. Although, the conceptual frameworks were published some time ago, we have witnessed a meteoric rise in the use of faire value as a measurement basis in financial reporting. The great challenge in recent decades is related to the identification of methods and indicators able to measure the effects that faire value produce in the new economy. Thus, the most recent studies have focused on developing tools to facilitate a better understanding and representation of faire value, meaning of this concept recognized and presented in a form without substance and in a substance without form. The present paper aims to capture the efforts made so far to assess and clarify need for convergence of this revolutionary concept in the context of new economy.

Keywords: accounting, globalization, standards

1 Introduction

The goal of fair value accounting is to estimate as best as possible the prices at which positions held would change hands in orderly transactions based on current information and conditions.

The contemporary accounting phenomenon has features based on the need or harmonization, convergence, compatibility and unity in book-keeping, seen also as general objectives of this field, which could be realized only by its normalization. The accounting convergence regarding the concept of faire value is the process of elaboration of accounting norms in a manner able to lead to a similar fact or goal, by stressing the similarity between national – regional – international levels.

The convergence regarding faire value is realized on two plans:

1. the convergence between the national and international standards;
2. international convergence IAS/IFRS – US GAAP

The competition between the American reference and the international one results in the improvement of the accounting norms, namely that they become more and more comparable, compatible but also more and more convergent.

A first dimension of convergence in accounting it is represented by the convergence between

the USA ACCOUNTING STANDARDS (USGAAP) an INTERANTIONAL STANDARDS OF ACCOUNTING (IAS/IFRS). Even if there were major differences between the two accounting referential regarding this concept, IASB and FASB agreed to identify all the points of disagreement in order to insure in a reasonable period the necessary convergence.

As it results from the strategy of the Council for Accounting International Standards, the objectives are oriented to 3 directions:

1. the elaboration of high quality international accounting standards, which can be understood and applied and which also impose high quality, transparent and comparable information. Thus, the participants on different capital markets and other information users can take efficient economic decisions;

2. the promotion for the elaborated standards rigorous utilization and application;

3. the collaboration with the national standards in order to maximize the accounting national standards convergence with the IFRS.

4. A second reason leading to the convergence of accounting systems are the desire for unity among conditions of competition in various countries. A synthesis of phenomena and aspects which could be considered as causes leading to the need for international accounting harmonization/convergence regarding faire value includes:

5. the economies encountering an accelerated process of globalization;

6. the requests from financial accounts users (a factor determined from the first one).

Thus, we shall aim towards a unity of economic language and accounting as an instrument of communicating information;

1. the extension process of the European Union;
2. the phenomenon of capital markets globalization.

In this context, the national and international intercessions have as a target realizing a convergence between national and international norms for a unique value (faire value). The appliance of this concept impose the outlining of it's utility, the knowledge of attainting techniques, assures much better than the historical cost the qualitative accountancy information and gives a plus to the user's certainty, because these one will be able to avoid the negative aspects, referring to the interest-evaluations and reliability of a patrimonial entity.

With the FASB having decided, in Statement of Financial Accounting Standards 157 Fair Value Measurement, that fair value is an exit price notion; the IASB is left to decide whether it agrees or not. Preliminary indications are that while the IASB may largely agree with the FASB's articulation of exit price, it may also see the need to articulate an entry price notion, because of the perceived use of that notion under the banner of fair value in some IASB standards. More specifically, some may make the case for the use of entry price on initial recognition of an asset or liability with a switch to exit price for subsequent measurement.

The fair value option is a step in the direction of making US GAAP more harmonized with

international GAAP, but it is a very small step. The main point in this module is that fair value adjustment of all financial and non-financial items on the balance sheet will not necessarily bring the balance sheet significantly closer to the fair value of the firm as a whole. The problem is that the value of the firm is most likely highly impacted by unbooked items that are not on the balance sheet and cannot be adjusted for fair value. Debate should therefore centre on the measurement attribute to be used in assessing an asset's recoverability; fair value, or the higher of value in use and fair value less costs to sell.

According with IFRS 13 changes in fair values reflect the effects of changes in market conditions when they occur. Therefore, they reflect the effects of management decisions to buy, sell, incur, extinguish or hold financial assets or financial liabilities on a timely basis.

2 Convergent of fair value concept between reality and myth

Edwards and Bell (1961) invite us to consider a semi-finished asset to enumerate the various dimensions through which we can describe the asset, and thus o calculate and define all the possible permutations arising from this multidimensional consideration.

Three dimensions are suggested:

1. the form (and place) of the thing being valued;
2. the date of price used in valuation;
3. the market from which the price is obtained.

They choose a subset of the alternatives in Table 1. for their own detailed theoretical development and appraisal.

Table 1. An array of value concepts - Form and places of asset

Value date, market	Initial inputs	Present form	Ultimate form-disposal	Ultimate form-use
Past, entry Past, exit	Historical costs Discarded alternatives	Discarded alternatives Discarded alternatives	Irrelevant Irrelevant	Irrelevant Irrelevant
Current, entry Current, exit	Current costs Irrelevant	Present costs Opportunity	Irrelevant Current market values	Irrelevant Current economic values
Future, entry	Possible replacement costs	Possible replacement costs	Irrelevant	Irrelevant
Future, exit	Irrelevant	Possible selling values	Expected market values	Future economic values

Source: Edwards and Bell (1961); last column: author

Over the years, the IASC has given a number of slightly different definitions of fair values, as following:

1. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction;
2. Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's-length transaction;
3. Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction

If we make a literature review, we can admit that fair value is a central concept in all the last three Standards issued by the old IASC, i.e. IASs 39, 40 and 41. Since the advent of the IASB in 2000, the onward march of the fair value concept has continued apace. The concept is included in the definitions section of IFRS 2, IFRS 3, IFRS 4 and IFRS 5. IFRS 7 cross - references the reader to the IAS 39 definition, and IFRS 6 allows the use of the revaluation model in IAS 16. The new single statement of financial performance towards which IASB, FASB and others are working is clearly designed to facilitate reporting under a fair value world. It is not yet officially in the public domain, even in draft, but sees Barker (2004). Notwithstanding these anticipated developments, the emanation of the fair value concept seems to have occurred more or less spontaneously, and certainly more or less haphazardly, over the past couple of decades, with no clear theoretical foundations (Warrell, 2002).

It is not surprising that there appears to be some consistency between the recent IASB statements discussed above and recent FASB comments. On 23 June 2004, FASB issued an Exposure Draft of a proposed Statement, 'Fair Value Measurements'. This proposes a definition of fair value as 'the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties, whose definition seems at pains to preserve semantic differences between FASB and IASB, rather than to seek convergence. FASB proposes a hierarchy of the inputs which should be used to estimate fair value (note that this hierarchy is concerned with measurement estimations, not with definition).

Fair value accounting – also referred to as "mark-to-market" accounting – has played an important role in U.S. generally accepted accounting principles (GAAP) for more than 50 years.

Beginning in 1979, SFAS 33 required large corporations to provide a supplementary schedule of condensed balance sheets and income statements comparing annual outcomes under three valuation bases: Unadjusted historical cost, Price-level adjusted (PLA) historical cost, and Current cost entry value (adjusted for depreciation and amortization). Companies complained heavily that user did not obtain value that justified the cost of implementing SFAS 33. Analysts complained that the FASB allowed such crude estimates that the SFAS 33 schedules were virtually useless, especially the current cost estimates. The FASB rescinded SFAS 33 when it issued SFAS 89 in 1986.

In 1993, FASB expanded the fair value recognition requirements by issuing a standard that required debt and equity securities that were held for trading or held for sale to be carried at fair value in the balance sheet and required changes in fair value to be recognized in the income statement or in a category of equity referred to as other comprehensive income. This was augmented in 1998, when FASB standards were adopted that required derivatives to be measured at fair value.

At the joint meeting of the IASB and the FASB in October 2005, the boards established explicit long-term objectives for improving financial reporting for financial instruments, to help the boards evaluate and prioritize future projects on financial instruments. In addition, the boards agreed to work towards those long-term objectives while retaining the ability to work either jointly or separately (if necessary) on shorter term objectives that are consistent with the long-term objectives.

An interesting slant on all this is given by the Discussion Paper Measurement Bases for Financial Accounting-Measurement on Initial Recognition (IASB, 2005). This document was written by staff of the Canadian Accounting Standards Board and published for discussion by IASB, and several other bodies. This proposes a four-level measurement hierarchy for assets and liabilities on initial recognition, as follows:

Level 1 Observable market prices; any adjustments are consistent with those that market participants may be expected to make.

Level 2 Accepted valuation models or techniques; all significant inputs are consistent with those that market participants may be expected to use.

Level 3 Current cost (i.e. reproduction cost and replacement cost); with the possibility of substituting historical cost, provided a reliable estimate can be made and the amount may be expected to be recoverable.

Level 4 Models and techniques that use entity-specific inputs only; when unavoidable and when not demonstrably inconsistent with those that market participants can be expected to use.

In 2006, FASB issued a new standard, FAS No. 157, Fair Value Measurements, which provided a single, consistent definition of fair value, established a common framework for developing fair value estimates, and required expanded disclosures about those estimates. FASB issued FAS 157 to address the complexities caused by differing definitions of fair value. Stated differently, FAS 157 itself does not prescribe any particular accounting treatment or require fair value accounting but does specify how fair value is to be determined when fair value is required by another standard.

FAS 157 establishes a hierarchy of valuation techniques that varies based on the availability of observable market information:

1. Level 1 inputs are “observable market data” – such as the quoted price for an identical stock or bond in an active market;

2. Level 2 inputs are “other observable market data” – such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; interest rate, yield curve and similar data that are observable at commonly quoted intervals; and other data that may be corroborated by market data (mark-to-market measurements); and

3. Level 3 inputs are “unobservable firm supplied estimates,” including the reporting entity’s own analysis of the underlying economic data that market participants would factor into the pricing of the asset or liability (mark-to-model valuations).

Convergence regarding faire value does not mean however the failure of accounting harmonization, but an obvious intercession aimed towards using an appropriate communication in a globalizing context, with the goal of having a common reference, International Financial Reporting Statements, while the short term goal of convergence is to eliminate the individual differences between US GAAP and the current IAS IFRS. Within this short term project, FASB analyzes various issues and either suggests alterations in the American norms, in order to eliminate the differences found, or it communicates to IASB the reason for which it decided not to alter the provisions of US GAAP, while at the same time IASB is carrying on a process of revising IFRS, taking, as the case may be, the same measures as FASB.

On 12 May 2011 the IASB and the Financial Accounting Standards Board (FASB) today issued new guidance on fair value measurement and disclosure requirements for International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP). The concept in IFRS 13 is that there are many types of factors which are taken into account in fair value. We can estimate if they are (1) a characteristic of the asset or liability in question (rather than a characteristic of the entity that holds the item); and (2) they would influence market participants’ pricing decisions. Even though IFRS 13 became a convergence guide regarding fair value, there are also differences between US GAAP and IFRS which refer to:

1. The recognition of day one gains and looses when fair value is determined using unobservable inputs;

2. The measurements as a certain alternative have a practical expedient in an investment company without a readily determinable fair value.

To sum up, IFRS 13 clarifies that fair value is a current price at the measurement date and explicitness reference to ‘market participants’, emphasizing that fair value is a market-based concept and assuming an orderly sale or transfer.

3 Conclusions

Moving from theory to practice, the question perhaps becomes: What are the informational advantages and disadvantages of the practicable proxies to fair value, value, both when applied consistently, and when applied pragmatically on an item-by item basis? This takes us back to the academically traditional debates on the pros and cons of the various theories of income measurement and asset valuation. Many academics and researchers have strongly held view on these issues. But since the fair value notion seems not to alter these debates, we leave our views until another occasion.

In essence, therefore, this concept in context of new economy gives a significant push towards current values in general and towards fair value in particular, but also strongly insists that fair value , as such must be genuinely based on market expectations, i.e. again, not entity- specific.

We consider that fair value is an attempt at current economic values, and current value in an active market is a proxy for it (in which case ignoring transaction costs is correct and necessary, because current economic value does not imply a current market transaction). But whether or not IASB sees it this way is not proven.

In conclusion is strongly supportive of current values and regards fair value as a valid contender for an appropriate current value, but, is not at all convinced by the apparent determination to avoid entity-specific measurements.

Convergence especially regarding faire value is not an easy thing! Even the president of FASB declared that the greatest challenge of the convergence process was to persuade the national business communities about the necessity for an international accounting language. Even if Securities Exchange Commission (SEC) and the multinational companies in the USA are privileged by this convergence, the small companies and the family level businesses are less happy. Perhaps people don’t like change in general, preferring rather to keep their status quo.

IFRS 13, which is effective from 1 January 2013, defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 does not determine when an asset, a liability or an entity’s own equity instrument is measured at fair value. Rather, the measurement and disclosure requirements of IFRS 13 apply when another IFRS requires or permits the item to be measured at fair value (with limited exceptions).

We can conclude that IFRS 13 Fair Value Measurement will improve consistency and reduce complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. On the other side, this standard reflects the FASB’s consideration of the different characteristics of public and non-public entities and the needs of users of their financial statements.

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