Universitatea Babeş-Bolyai
Facultatea de Stiinţe Economice şi Gestiunea Afacerilor

Ph.D. THESIS

-SUMMARY-

New valences of measurement in accounting

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SUMMARY OF THE THESIS

KEYWORDS

fair value assessment, measurement bases, historical cost, financial reporting, accounting regulations, relevance, theoretical studies, taxonomy, regression analysis.

RESEARCH MOTIVATION

The debates on the assessment of accounting date back nearly a century, finding its genesis point in the writings of MacNeal (1939), Ijiri (1975) and Sterling (1970). Until now, our knowledge of this subject have greatly advanced, but the continuous changes in accounting regulations, the multiple perspectives from which it is treated, and especially its importance, assures us that such knowledge will further increase.

Without any doubt, measurement in accounting is an extremely broad subject, covering a variety of attributes, definitions and regulations. It is not our intention to propose a comprehensive analysis of this area, but rather only an overview of the main evaluation rules, and later to focus our efforts on a widely debated and controversial concept, namely fair value. We were convinced of the importance of assessing the fair value by the thousands of pages we read on this subject and we hope that this work will bring better understanding of this concept, and why not curiosities and future research questions. Other arguments for choosing this research theme are the mixed results offered by the previous literature, the practical complexity of this area and the concerns of regulators in this direction.

Over the past decades, the information in fair value experienced a significant increase in financial statements and therefore the financial reporting has become more complex (Bratten, Choudhary, & Schipper, 2013).While the measurement at fair value are recognized as being useful to the participants of the capital market (M. E. Barth, 2015), they are often subjective and unobservable (Cannon & Bedard, 2015). Thus, the formulators of financial statements must exercise considerable judgment in preparation of the financial statements to faithfully represent the economic reality. The explosive development of new and complex financial instruments (i.e. derivatives, interest rate swaps, etc.), the requirements of international and US accounting standards, and economic turbulence have also contributed to the debate on the assessment of fair value. Given the confluence of these factors, questions such as: *How is fair value defined and how can it be measured when there isn't an active and representative market? What are the advantages and disadvantages of such accounting and how do the accounting standard organisms regulate it? How is the fair value measurement seen by academics and how is fair value information perceived by users of financial statements?* will find their answer in this work.

From a practical standpoint, complexities in accounting valuation has increased significantly in recent years, with an increasing level of uncertainty in the assessment, due to the global financial crisis. A new layer of difficulty is added to fair value financial reporting, because of problems specific to the evaluation profession linked to methodology, availability of information, and how to approach complex situations (Stanciu, 2014).

Evaluation of accounting in general, and fair value measurement in particular are on the radar of regulators for a considerable period of time. Regulating standards have the difficult task of designing a conceptual framework that enhances the comparability of financial statements by ensuring that similar elements are measured in a similar manner in similar situations, while recognizing that different situations require different measures of assessment (Whittington, 2015). Thus, they must choose the valuation methods that better reflect the economic substance of the elements of the financial statements. Currently, measurement problems are an important part of the exposure draft (ED 2015/3) intended to improve the conceptual framework of financial reporting.

INTRODUCTION

To reach our goals, we have structured the thesis in four chapters, which often interferes to finally form a unified and well-put together study. As is natural, our approach starts by framing the conceptual delimitation and the corresponding fair value in the sphere of comprehensive assessment in accounting. Thus, to the mission of the first chapter, namely the creation of an overview of valuation in accounting, two secondary endpoints are added. They refer to (i) determining the genesis points genesis in the debate historical cost – fair value (ii) defining concepts on fair value and historical cost. To this end, in the first part we focus on identifying theories tangent to our research field and highlighting key aspects useful in understanding the motivations that underlie disputes viable solution in choosing appropriate measurement base. We believe that a theoretical foundation in accounting assessment would not be complete without an analysis of the main attributes of evaluation, fair value and historical cost, as they are presented in the international accounting referential, american and national. We chose thus presenting them in the end of the first chapter.

The second chapter is dedicated to carrying out a study on the current state of knowledge on fair value, a study that in our view is an essential part of a research process. Our goal is not a critical review of the opinions set forth in the literature or reinterpreting the studied writings, but the establishment of a foundation anchored in the literature and an analysis of the history of measurement bases. To synthesize the current level of knowledge in this field we conducted a qualitative analysis of the main directions of research in the field of fair value, highlighting the main aspects analyzed and the results achieved under each theme, thus identifying possible new research directions. As a natural continuation of the literatures' review, the reason being that the literature revealed an inconsistency in addressing fair value, we intend then to delimit conceptual fair value from the perspective of the models proposed by Papineau (1979) and Hesse (1980).

Through the third chapter, we want to treat the legislative side, as it is the basis for achieving economic activities. Therefore, the main objective is to achieve a comprehensive approach aimed at capturing all aspects of accounting regulations at national and international level in terms of accounting model based on fair values.

Before presenting the accounting regulations regarding measurement in accounting, we stopped for a few rows on the individual valuation of detailing bases, through a doctrinal research and not through the literature. We consider this step important in order to have an overview of valuation in accounting and identifying some initial connection, to be able then to provide taxonomy of measurement bases. Getting to this point in our research, we consider appropriate to analyze the impact of accounting information on the characteristics of the measurement bases.

Given the current trends on the assessment for financial reporting, which indicates the existence of an evolutionary process of evaluation sheets, leaving slowly the historical cost and heading for one of the forms of present value, namely fair value, we build our way further on achieving a global approach to accounting regulations on fair value. We find justification for this development in business process changes, in significant differences in value between the historical cost and current value, and in the vulnerability of historical cost manipulation. Taking into account the importance that international regulation has on fair value accounting model, we analyzed international reference (IFRS) and North American (US GAAP), considering that they have the greatest impact worldwide. In addition to presenting the evolution of international and American standards on fair value accounting model we have done a brief overview of the directions provided by the assessment standards. In concluding the chapter, we present national accounting regulations. In order to achieve this step we conducted a longitudinal analysis.

The last chapter is dedicated to the analysis of the relevance of fair value information for users of financial statements. For this purpose we analyzed the relationship between the quality of accounting information and financial analysts forecast accuracy. To achieve our purpose we focused on real estate investment industry in Europe over the period 2007-2014. This context is unique because it allows us to differentiate between companies that choose to recognize investment property at fair value in the financial statements with the related amendments in the balance sheet and companies that choose to report investment properties at cost and disclose their fair value in the financial statements notes. So in this chapter we want to document whether this choice affects the accuracy with which the analysts estimate the firms revenue. The study results indicate that companies that choose to recognize investment property at fair value enjoy higher analysts' forecasts accuracy compared to companies that choose to recognize investment property at cost, presenting fair value in the financial statement notes. Moreover, the presence of an external appraiser and times of economic crisis do not change the perception of the accounting numbers reported in the financial statements at fair value and the ones reported at cost with the fair value presented in the footnotes. An additional test shows the determinants of the firms' decision on how to report investment property.

The abovementioned objectives of this thesis, and taking into account the results of the research and conclusions based on them we consider that the objectives we have set have been met.

CONCLUSIONS, CONTRIBUTIONS AND LIMITATIONS

At the end of this paper, we propose, as is natural, to present the main conclusions and the achieved results drawn during the research. We will also specify the limitations of the undertaken study and future prospects of research evaluation in accounting.

In the first part, the research approach was aimed at identifying the factors that led to the paradigm shift in the changes in the assessment and evaluation system for the purpose of providing solutions to a number of problems arising from the evaluation work.

Thus, the first two chapters have had as main objective to outline a picture of measurement in accounting. If in the first chapter we focused on determining genesis points in the opposition of historical cost - fair value, focusing in more detail and defining these principal measurement bases, the second chapter was dedicated to the delimitation of the current state of knowledge in the field of fair value from the perspective of the prior literature.

Characterized by a number of positive aspects, such as the large number of articles in the sample, the relevance of the selected international journals, the complexity of qualitative analysis and the comprehensive achieved synthesis, the study is not without limitations, which we present in the following.

- The review period of only 25 years, given that international research in the field of evaluation is dating back to the 60s, does not allow us to outline a complete picture of trends, of the avenues of research. However, we believe that currently analyzed research, reflects sufficiently clear the current state of knowledge;
- The sample analyzed included the highest rated 25 international journals, which are representative of the study, but that limit our research because most articles are written by researchers from the US and UK;
- The sample was limited to those items that have been selected based on the keywords *fair*, and *value*, a larger keyword count would be leading to an extremely large and difficult to analyze sample.

On the qualitative study conducted in Chapter three, we conclude the following about the main directions of research addressed internationally:

- The results of empirical research on the relevance of one of the top measurement bases are dispersed. However the overall conclusion would tend to move toward the use of information supremacy in fair value, although this utility varies depending on the source of information (Song 2010: 1380). Overall, there seems to be more support for the hypothesis that the fair values have incremental explanatory power in comparison to historical costs than against them, but the results cannot be considered conclusive. Concerning this, Barth & Landsman (1995: 97) concluded: when assets are traded in complete and perfect markets, the balance constituted in fair value reflects the usefulness of information to all of the presented values, profit or loss cost is redundant, the realization of income value-relevance is not useful, and otherwise the balance sheet and profit or loss does not reflect full and useful information, and the realization of income can be useful information, although management opportunism can diminish its relevance;
- The profit reported on the market is more volatile than those reported at historical cost or amended historical cost basis;
- Although to some extent it is eliminating the risk of opportunistic earnings management by the managers, fair value valuation model can create difficulties in assessing managerial skills. Therefore, fair value can lead to inefficient managerial attitudes aimed at maximizing the value of the company at the expense of a development strategy;

- Although there are allegations of opportunistic behavior regarding to goodwill depreciation related to reporting, the conflicting results of prior research suggests that if this effect exists, it isn't omnipresent. This divergent results create the potential for future research in this field in order to elucidate this issue;
- The case of Enron is an extremely widely debated subject, a series of analyzes being carried out in the prior literature, but the results do not indicate guilt of the fair value concept (Bonaci, 2009: 228). Moreover, it was demonstrated that the lack of an adequate, effective and well protected internal control system, was that created opportunities for abuse and manipulation of fair value accounting (Barlev & Haddad, 2004 Bonaci, 2009: 228);
- A careful analysis of the benefits, but also of the inconveniences posed by the accounting model based on fair value leads us to conclude that, while fair value is useful in some situations, this is not a basis for evaluation of general application. However we should not see the disadvantages of fair value as advantages of historical cost (Power, 2010: 199). As a conclusion of this review of the advantages and disadvantages of fair value, we underline that despite their weaknesses, fair value still does not have a true competitor (Power, 2010).

Even if before we were witnessing a split in the directions of development defined by the activity of the normalization and specialty literature (Guse, 2011), now the options of the two communities seem to be aligned. It can be said that the concerns of regulatory bodies for the moment are moving away from improvements from fair value valuation as unique evaluator basis (Whittington, 2015). Our contribution in this chapter is to filter the current state of knowledge through our own presentations vision, delineation absolutely necessary for innovative research.

In the third chapter, we look at the legislation, as this is the basis for achieving economic activities. The main objective is to achieve a comprehensive approach aimed at all regulating aspects of accounting at national and international level in terms of accounting model based on fair values. Also in this chapter we studied the perspectives of international valuation standards. Examination reveals a certain inconsistency with international regulations on the use of fair value under IFRS. On the one hand, there is a belief that international standards are headed to a fair value, but on the other hand Cairns (2006) and Nobes (2015) notes that these views suggests a lack of understanding of international accounting standards. They argue that fair value is limited to unusual items or unusual entities and most companies do not value assets and liabilities at fair value for financial reporting, except for financial instruments. National accounting regulations analysis indicates a somewhat more explicit adoption of fair value by converging with the international accounting standards. A limitation of this chapter is that we focused only on what the national and international treaties without treating European directives on the issue of valuation in accounting generally and the fair value model in particular.

The last chapter is dedicated to the analysis of information relevance of fair value for financial statement users. For this purpose we analyzed the relationship between the quality of accounting information and financial analysts forecast accuracy. The study results indicate that companies who choose to recognize the fair value of investment property in financial statements enjoys greater analysts forecast accuracy compared with companies which choose to disclose the fair value of investment property in footnotes. We can add that the presence of an external evaluator and downturns in the economy does not change the perception of fair value disclosed in the financial statement notes. In an additional test we document the fact that the variability of cash flows, the firm's commitment to provide transparent reporting and in accordance with the best practices of the industry, company size and degree of indebtedness explains the decision of the manager to the method of reporting of the real estate investments. This chapter helps to enrich the literature in three ways. First, it contributes to the debate on the use of fair value as the measurement basis in financial reporting. Secondly, the work contradicts the conclusions certified by Bratten, Choudhary et al. (2013) and Müller et al. (2015), by documenting the results showing that financial analysts do not perceive in the same way the accounting numbers presented in the financial statements and disclosed in the footnotes, even if the disclosed information is trustworthy. Thirdly, the study sheds light on an issue rarely addressed by academics namely the proper use of fair value for financial analysts.

Synthesizing and taking into account that stated before, it is natural to wonder what would be our contribution to the state of knowledge of the field in pursuance of the theoretical and applied research to the scientific approach proposed. Such our concerns regarding to fair value positioning in the broader specialty literature were:

- Identification of genesis points in the enforceability historical cost - fair value;
- A pertinent analysis of the prior literature in the field of fair value, identifying the main themes;
- Delimitation of the conceptual framework using the fair value model based on the Papineau approach (1979);
- The history of the prior literature on fair value using the model developed by Hesse (1974, 1980);
- Developing a taxonomy on measurement bases;
- Analyze the implication of accounting information characteristics on assessment bases;
- Chronology of fair value occurrence in regulatory standards;
- Outlining an overall view on the regulation of international and national accounting evaluation in accounting;
- Contribution to the debate through empirical study on the use of fair value as the measurement basis in financial reporting, debate involving both academics and practitioners.

Given the results of research and conclusions based on them, which we discussed above, we believe that the objectives we have set ourselves at the beginning of this paper have been met.

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