



Representing the market perspective: Fair value measurement for non-financial assets



Richard Barker ^{a,*}, Sebastian Schulte ^b

^a Saïd Business School, Oxford University, United Kingdom

^b Judge Business School, Cambridge University, United Kingdom

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ABSTRACT

Fair value measurement (FVM) in IFRS calls for a market-oriented representation of economic 'reality', whereby the values attributed to rights (assets) and obligations (liabilities) are in principle determined from the perspective of the 'market participant' rather than that of the reporting entity. We argue, however, based upon Searle's analysis of institutional reality, that such rights and obligations exist and are knowable only under certain conditions, that when those conditions hold FVM is not distinctive, and that when they do not hold the requirements of FVM are wishful and incoherent. Based upon this analysis, and using case study data, we explore how FVM is applied in practice to non-financial assets. We find, for a predominance of core operating assets, that fair value is unknowable, because of the absence of the institutional reality on which the FVM idea implicitly depends. In these cases, actors' representations of fair value were found to be expedient, unstable and ultimately in direct contradiction of the market participant's perspective that is 'wished-for' in IFRS.

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Introduction

At the heart of the method of financial accounting is the balance sheet, which is a representation of economic 'reality', in the form of a summary of the rights (assets) and obligations (liabilities) of a reporting entity. That representation, undertaken in accordance with prevailing accounting standards, can be viewed as a process of translating activities and events into financial metrics (Robson, 1991) and, thereby, as a mechanism for enabling economic discourse with respect to those activities and events (Burchell, Clubb, Hopwood, Hughes, & Nahapiet, 1980; Hopwood, 1987). The accounting process is not neutral in this regard, however, and what counts as an accounting representation changes over time (Burchell, Hopwood, & Clubb, 1985; Davis, Menon, & Morgan, 1982; Hines, 1988; Miller, 1998). The map-making metaphor proposed by standard-setters themselves is therefore rejected by Hines (1991), while Young (1994) describes accounting problems as being constructed as opposed to simply 'being there,' and Young and Williams (2010) identify the value judgements that are unavoidably implicit in identifying and classifying amounts required to be recognised in the financial statements.

Instead of accounting representations being neutral, Davis et al. (1982) and Morgan (1988) view them instead as partial, being determined by reference to the defining attributes of a chosen metaphor. So, for example, representation according to an 'accounting as history' metaphor is concerned with 'providing a faithful record of the transactions of an enterprise' (Morgan, 1988). The image of accounting here is one of serving the function of social memory (Basu, Kirk, & Waymire, 2009) and of providing an account of the stewardship of resources (Ijiri, 1983; Murphy, O'Connell, & O'hOgartaigh, 2013). This leads to an emphasis being placed on information that is perceived to be reliable and verifiable, that can be 'counted on' to underpin consensus in preparation and use (Ijiri & Jaedicke, 1966). These are informational characteristics typically associated with historical cost accounting (Ijiri, 1983). An alternative metaphor, also proposed by Morgan (1988), is 'accounting as economics', which is 'the view that accounting should try to mirror current economic realities and reflect basic economic principles.' While the development of economic thought can be said to have itself built upon a metaphor of accounting practice (Klamer & McCloskey, 1992), 'accounting as economics' reverses that causation. The image here is one of economic theory guiding accounting practice, with accounting information seeking to capture current market prices and to inform current, economic decision-making. Varying in emphasis, for example from seeking to determine

* Corresponding author.

profit as a measure of economic performance (e.g. Edwards & Bell, 1961; Sterling, 1970) to simply viewing accounting information as an input into investment decision-making (Beaver, 1989), a common theme here, in contrast with ‘accounting as history’, is an appeal to the underlying discipline of economics, and so to the importance of market signals and expected cash flows in the determination of accounting practice.

In this paper, we interpret the introduction of fair value measurement (FVM) in IFRS as a shift in metaphorical construct, from the historical to the economic, and so also as a shift in the accounting representation of economic ‘reality’. Our aim is to explore the nature of this change, and to make a research contribution that is both theoretical and empirical.

The paper is structured as follows. In Section ‘Accounting as economics: the fair value idea’, we position fair value in IFRS 13 as a transforming idea, as an extension in accounting of an underlying logic of financial economics, which introduces a concept of ‘the market’ to replace a more traditional, transaction-based perspective of accountability and stewardship (Morgan, 1988; Power, 2010; Ravenscroft & Williams, 2009). Explicitly shifting the emphasis in accounting practice, from what the IASB terms the ‘reliable’ measurement of carrying amounts in the balance sheet, to the IASB’s more recent conception of the ‘faithful representation’ of what the current values of assets might hypothetically be, FVM points towards change in the accounting representation of economic ‘reality’. This idea of fair value in IFRS 13 contains several implicit assumptions, both about the ontological nature of the ‘reality’ that is being represented in accounting, and also about epistemological claims that can be made with respect to that ‘reality’. In Section ‘Searle’s analysis of the nature of institutional reality’ we draw upon Searle’s analysis of social reality (Searle, 1995, 2010), in order to provide a theoretical basis from which these implicit assumptions in IFRS 13 can be made explicit, and thereby better understood. Of central importance here is Searle’s notion of an ‘institutional fact’, which is something that can be known objectively about an institution. In turn, and as will be explored in greater depth in Section ‘Searle’s analysis of the nature of institutional reality’, an institution in Searle’s analysis is an agreed-upon means for creating rights and obligations among agents (Searle, 2005). Financial reporting, being concerned with economic rights and obligations, can therefore be seen as a system for representing institutional facts. This notion is applied in Section ‘FVM and the representation of institutional facts’, which brings together the previous two sections, applying theory in Searle to the analysis of FVM in IFRS 13. We argue that the process of representing fair values in financial statements does not in itself involve the creation of institutional facts. Rather, the preparation of financial statements involves either the reporting of institutional facts already in existence, or else the creation of data that cannot themselves constitute new institutional facts. We show that the second of these two possibilities undermines the generality of the fair value idea that is presupposed in IFRS 13, because there exists neither an institutional reality to be represented nor the possibility that such a reality can be ‘known’. We also show that this undermines the IASB’s conceptual shift from the notion of ‘reliability’ to that of ‘faithful representation’, because that shift is redundant when institutional facts are already in existence, while it is incoherent when they do not already exist. In Sections ‘Fieldwork’ and ‘Case study evidence’, we turn to the empirical components of our paper. Section ‘Fieldwork’ summarises our research method, which employs case study evidence, from companies in Germany, Switzerland and the UK, to explore how FVM is interpreted and applied in practice. Section ‘Case study evidence’ then sets out the case study evidence from our fieldwork. We find that, faced with the conundrum that there is an absence of institutional facts, yet also a *requirement* to implement IFRS 13, preparers of

financial accounts sought to represent fair value in one or more of the following ways: transferring the problem elsewhere, narrowing the problem to make it more tractable, or finding an expedient solution by subverting the requirements of IFRS 13. We suggest that these practices led to a varied and inherently unstable accounting representation of fair value, at odds with the fair value idea that is wished-for in IFRS 13. In Section ‘Conclusion’ we bring together theory and evidence, drawing out and discussing the main findings and implications of our research.

Accounting as economics: the fair value idea

Fair value has emerged in recent years as the preferred measurement model of the IASB. As described by a former IASB board member, ‘fair value meets the conceptual framework criteria better than other measurement bases considered’ (Barth, 2007). Along similar lines, another former board member concluded that ‘fair value is here to stay ... conceptual support for fair value is demonstrable’ (McGregor, 2007). Fair value has duly appeared in accounting standards introduced by the IASB, such as IFRS 2, IFRS 3 and IFRS 9, as well as in revisions to earlier standards, such as IAS 16 and IAS 36 (IASB, 2013), and most recently in proposed revisions to the IASB’s Conceptual Framework.¹ While the 2008 credit crisis somewhat tarnished the status of FVM, any serious alternative to fair value in IFRS has been conspicuous by its absence. Indeed, IFRS 13 is unique in being the only official IASB pronouncement with the explicit purpose of setting out a theory and practice of measurement.

There are two respects in which the adoption of FVM implies a transition from ‘accounting as history’ to ‘accounting as economics’. First, in contrast with a more traditional, transaction-based perspective, FVM is explicitly market-oriented, whereby the perspective of the market is proposed as the foundation for accounting representation. Second, IFRS 13 insists on the *generality* of a market perspective, whereby the objective to report market values holds whether or not markets themselves exist, which leads to what Power (2010) terms a ‘transformation of reliability’. In this section of the paper, we set out and discuss these two defining aspects of the fair value idea.

At the heart of IFRS 13 is a distinctive concept of ‘the market’. This is consistent with the ‘accounting as economics’ metaphor, with its emphasis on current market prices as a guide to economic decision-making. The centrality of the market concept is indicated in the stated objective of FVM in IFRS 13, which is ‘to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions’ (para 2; italics in the original). Implicit in the characterisation of value as ‘fair’ is that it represents the outcome of an arm’s length agreed exchange, of an ‘orderly transaction ... between market participants ... under current market conditions.’

In the following extract from its conceptual framework, the FASB summarises the ideological appeal of this market orientation (FASB, 2000, para. 26):²

Among their many functions, markets are systems that transmit information in the form of prices. Marketplace participants attribute prices to assets and, in doing so, distinguish the risks and rewards of one asset from those of another ... An observed market price encompasses the consensus view of all marketplace

¹ It should be noted that the incorporation of fair value in proposed revisions to the IASB’s Conceptual Framework is in the context of a mixed measurement model, as opposed to a ‘full fair value’ approach.

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