FAIR VALUE MEASUREMENT IN AGRICULTURE AND THE POTENTIAL TO MISLEAD

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Abstract
Applying fair value measurement to tangible and intangible assets in agriculture cannot be risk free. Twofold reasons can be brought into attention for the above statement: fair value estimation and the specific of agriculture field. The purpose of this discussion paper is to underline potential creative accounting demarches that can appear in this context. The paper concludes based on the discussions approached in the literature. Further avenues of research are discussed.

Keywords: IAS 41, creative accounting, fair value, accounting treatment

JEL Classification: M40, M41

1. Introduction
In the last years, various modifications called for attention in the agriculture field. One of the main differences is the attention received from the regulatory authorities in terms of accounting standardization in the agriculture sector. One of the items of standardization was the fair value measurement that suppressed the historical cost as importance. Considered as being one of the best ways to assess the value of both tangible and intangible assets in agriculture, the fair value was implemented and from that point used.

The objective of the present study is to assess either the fair value accounting inserted by IAS 41 can lead to mislead practices by recurring to creative accounting.

In the aftermath of the 2008-2009 global economic crisis, fair value was judged and found guilty by most of the scholars. It was stated that one of the most important factors that contributed to financial crisis was fair value accounting. The main idea introduced by scholars worldwide is connected to the use of fair value by some accounting practitioners, use that can lead to manipulation. Also, fair value has been criticized of not being the best measurement attribute for decision-useful information for the users of accounting information (Barth and Landsman, 2010).

2. Methodology
This paper discusses the main findings in relation with fair value estimations and the area of agriculture. Some of the discussions are related to IAS 41 and IAS 38. Being more a discussion paper, no empirical data is examined and analyzed, nor statistical computations.

This section explains the method used for selecting the papers included in the discussion. In this respect for selecting the papers a similar method such as Guthrie et al. (2012) was used. The selection process was over when the full version of the papers that fall under the interest of this study were downloaded and stored in an Endnote. The keywords used in the searching process were: fair value, creative accounting and agriculture.

The main research question that will be used as a genesis point for the discussions comprised in this paper is: Applying Fair Value Measurement to Tangible and Intangible Assets in Agriculture Can Lead to Creative Accounting?

This study being a fundamental one does not search to solve any problem, moreover to serve and ensure the right premises for forthcoming discussions.

3. Fair value accounting and the potential to mislead
Fair value is defined by IASB as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between knowledgeable market participants at the measurement date.

This study does not seek to argue for the disadvantages of fair value and to assess it only based on the shortcomings introduced. The author of this paper is aware of the advantages introduced by this measurement base. Moreover this paper seeks to increase awareness in regard of the use of fair value in very specific field as agriculture. Also, IAS 41 is discussed under the possibility of introducing potential items for manipulation.
Previous research documented that fair value introduction has a significant impact on accounting and audit practice (Nobes, 2010). According to fair value paradigm, fair value accounting has the capacity to enhance the stewardship function by providing relevant information to stakeholders (Barlev and Haddad, 2003).

One of the main arguments was related to the potential to manipulate earnings using this measurement basis among this being: its increased subjectivity comparing to historical cost (Watts, 2003); increase magnitude of expectations that turn out to be false (Rayman, 2007); increase in unrealistic fluctuations in net profit (Penttinen et al., 2004); increased volatility (Barth, 2004; Herbohn and Herbohn, 2006); lack of reliability that comes from the fact that easily can be subject to manipulation (Liang and Wen, 2007; Ronen, 2008).

In regard of IAS 41, it can be asserted that it brings a continue debate into the agricultural accounting domain (Elad, 2007). Most authors are critical with the requirement of fair valuation for biological assets and value changes to be recognized in profit and loss statement. Fair value suffers from a lack of reliability and combined with a sensible domain like agriculture can lead to various accounting manipulations (Elad, 2004).

4. IAS 41 specificities and fair value problem

IAS 41 established the accounting treatment for the accounting recognition of the biological assets, process that finishes with the harvest. Having a standardization scope, this particular regulation comprises the accounting treatment and disclosure of the financial statements in activities related to agriculture. Having as main objective the improvement and harmonization of the methods used for recognition and valuation, this standard assess the impact of the economic transactions related to agricultural activity (Nobes, 2008).

IAS 41 introduces for biological assets the fair value measurement. Defined as the amount for which an assets could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction, being independent from each other, fair value compared with the historical cost is considered more controversial.

Taking into account previous studies that assessed fair value measurements, the main findings indicate a highly potential to misleading. The main research question here, as stated above, is related to the agriculture field to contribute to the occurrence of such manipulative issues, as creative accounting practices. Also, is fair value in agriculture more susceptible to manipulation?

The computations used to obtain fair value for biological assets or agriculture products, may come easier if one similar attributes are found and compared. These attributes are particular characteristic when the market's price is determined. In this context fair value is considered the best measurement. Offering guidance on measurement of fair value, IAS 41, comprise the following directions to be used: 1) contract prices to sell at a future date are not necessarily relevant in determining the fair value of a biological asset or agricultural product, because fair value reflects the current market rate in which a willing buyer and seller would enter into a transaction; 2) if an active market exists for a biological asset or agricultural product then the quoted market price represents the most reliable basis for determining the fair value of the asset. If an active market does not exist then IAS 41 provides alternatives; 3) in some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances the present value of expected net cash flows should be used, discounted at a current market-determined pre-tax rate; 4) Cost may sometimes approximate fair value when little biological transformation has taken place since initial cost occurrence, or, the impact of the biological transformation on price is not expected to be material.

What happens when managers lack guidance for certain measurements? In contexts with low investors protection or week corporate governance manipulative practices are known to arise without great difficulty.

For instance, IAS 41 requires for biological assets to be marked to market prices at the end of each financial year. In this case either gains or losses can be obtained and they are taken into account when income is computed. So far, the standard offers the great expectations for accountants to follow. What happens when fair value for agriculture products cannot be assessed reliably? In this case, IAS 41 recommends the use of surrogate’s values to replace the market value. Among those items like: sector benchmarks, independent professional, values of similar agriculture products or the present value of future net cash flows that the asset can be used. According to managerial discretion, managers can deliberately choose in practice, between different fair values accounting measurement in the agricultural sector. In this a considerable subjective managerial discretion can be used for valuation of biological assets that are extremely difficult to assess like forests or grapevines. Other opportunities of manipulation are related to the difficulty of establishing the fair value of a biological asset increases when the asset is a bearer asset (which itself will not eventually become agricultural produce) and the more long-lived the asset is. A good example in this sense would the Romanian vineyards, as we know the grapevines have long lives and it is not uncommon to have productive vines many years being capable of production. IAS 41 does not require external independent valuations for these particular cases. As a result, if ethics lacks, the managerial discretion may be subject to bias and manipulations, in a higher amount compared with the historical cost base of measurement.

Comparing to the historical cost, fair value is considered as being more decision-useful. Similar concepts can be applied also to the modified historical cost. The main critics related to fair value measurement arises when there are no observable prices on which fair value estimates can base on. In this respect, the estimates can lack decision.
usefulness and so management can turn easily to manipulative activities, even if the regulations specify how to estimate fair values. Further critics contend that when prices are observable, fair value estimates also can lack to reflect the dimensions of assets values in cases when managers deal with informational asymmetry.

Argued as a promoter of global convergence of farm accounting practices, IAS 41, can further comprise more necessity to explore potential shortcomings.

One of them is approached above. Others can be related either to the volatility introduced into reported profits (Barth, 2004) or to the allowance for recognition of estimates in income statements that can result in significant adjustments in subsequent periods. The latter issues can conduct to an increase of smoothing behavior used by managers who seek to disclose a perfect image for their companies.

Based on the above, IAS 41 offers and encourages for highly valuations, and moreover the apparent tool for exercising the professional judgment like the replace of fair value with the historical cost also, since there is the possibility for managers to want to use the second measurement base when circumventing the onerous requirements to measure biological assets at fair value.

Other item that has the potential to lead to creative accounting activities is related to the large variety of regulations for certain segments applied in agriculture. For instance, IAS 41 does not apply to the following categories like: agricultural produce after the point of harvest, (this is a point where IAS 2, Inventories, applies); the land on which the biological assets grow, regenerate and/or degenerate (IAS 16, Property, Plant and Equipment, IAS 17, Leases, or IAS 40, Investment Properties, applies as appropriate); any intangible asset associated with the agricultural activity, for example: licenses and rights (IAS 38, Intangible Assets, applies); agricultural activity that is not managed, for example: harvesting from ocean fishing; minerals, oil, natural gas and similar non-regenerative resources (not yet covered by an IAS).

5. Conclusions and scope for future research

IAS 41 requires recognition at fair value less the estimated point-of-sale costs. In comparison with other IFRS standard the changes in fair value are immediately recognized in the profit or loss account, with an immediate influence on the result. Recognizing in the income statement the changes in value due to the transformation process this will lead to a higher volatility of the annual statements and in this direction at a higher prognosis risk for the users of the financial statements.

As it was stated above many authors complain that fair value measurement base is considered an important departure from the convenient valuation method and will entail serious drawbacks for the agricultural sector, disadvantages at least in terms of credibility in financial statements produced by this domain.

As regarding further development, comparison tests between samples of farms that use fair value and historic cost for biological assets evaluation can be performed. Using Eckel (1981) income smoothing index fair valuation increases due to accounting manipulation can be assessed.

6. References


