FAIR VALUE ACCOUNTING CRISIS DEBATE – A REVIEW

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Rezumat
The last decade characterized by financial crisis and global context changes put into discussion the fair-value accounting. Both the professionals and the academics debated even the role of the FVA in the crisis mechanism and its limitations regarding the business environment protection against the crisis effects. Our paper reviews the different opinions and doctrine trends discussing the future of FVA accounting, challenges to be tackled and proper improvements.

Cuvinte cheie: *fair value accounting, crisis, debate, review*

Clasificare JEL : *M40, M41*

1. Introduction

As is stated by the US GAAP, the fair value is a market-based measurement and not entity related one. The given definition focuses on the price that would be set for selling the asset or paid for transferring the liability (the exit price) and not the price to be paid for acquiring an asset or received to assume a liability (the entry price) (US GAAP, FAS 157). IFRS also discusses that in the absence of quoted market prices the enterprise use valuation techniques and market information so the valuation maximizes the use of observable inputs (IAS 39).

As the continuous search for a proper instruments and more reliable methods go on IFRS 9 (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) was issued in November 2013. It was established for “permitting an entity to elect to continue to apply the hedge accounting requirements in IAS 39 for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities when IFRS 9 is applied, and to extend the fair value option to certain contracts that meet the 'own use' scope exception”.

2. The debate

Under both U.S. GAAP and IFRS framework the fair value is mostly used for financial assets and liabilities due to the market conditions and specific characteristics of these.

The debate upon the FVA accounting role and importance in the financial crisis mechanisms is centered on two main affirmations. The first state that the fair value accounting not only contributed to the crisis tidal wave but also exacerbated the negative effects (Nuţă, 2014). The second group of actors argue that it is the same thing as we “shoot the messenger” when we are blaming the FVA, because it is only a measurement system and nothing more (Laux, Leuz, 2009; Turner, 2008; Veron, 2008). The less partisan opinion and somehow neutral one is that the fair value accounting is in many situations a necessary evil, and without it worse would happen.

Table no. 1. **Pros and cons debate review**

Accusing FVA	Defending FVA
Some consider that fair value accounting adds both volatility and contagion to the market. It also brings high leverage in time of economic expansion and write-downs when the economy shrinks (Laux, Leuz, 2009)	Laux and Leuz consider that the fair value accounting is not an option but a necessity due to the fact that the business model for investment funds and other financial institutions is based on market values. Moreover a less transparent approach (historical cost accounting) would harm more instead of protect the business environment
Forbes (2010) argues that the “mark-to-market” accounting was the main reason for	One of the main argument supporting the cause of the fair value accounting is that it

the financial crisis threatening to destroy the financial system	better (than the historical cost accounting) identifies and describes the risk of the financial instruments. It also better reflects the underlying economic value of those instruments (Plantin et all., 2008). So one the pro argument is the transparency (Boyer, 2007)
Arya and Reinstein (2010) also discuss that the fair value accounting exacerbated the global financial crisis by forcing the write-down of assets based on their low market prices	Another thing many times mentioned by authors is that the fair value accounting is only the messenger providing information for investors, managers or decision makers, and when it is properly implemented ensures the simplification and more ergonomic way to be informed (Levitt, Turner, 2008)
Not affirming necessary the role of fair value accounting in the beginning of the crisis, Allen and Carletti (2007) argue that in imperfect market conditions (determined by the crisis) the “market prices” usually reflects the buyer’s low liquidity instead of the asset’s fair value	The historical cost accounting does not properly record the losses. Allen and Carletti (2007) affirm that “historical cost accounting masked the problem by allowing losses to show up gradually through negative net interest income. It can be argued that a mark-to-market approach would have helped to reveal to regulators and investors that these institutions have problems.”
When the crisis expands and extends its effects, instead of clearing the market conditions, the fair value accounting contribute to the spreading effect the markets for the affected assets being frozen (Moyer, 2008)	Until the world financial crisis was a fact that the FAS 107 were instated for transparency reasons, given the example of the Japan’s economic crisis when loses of billions of dollars were hidden and it came to the public knowledge it was too late to recover (The Economist, 2008)
Magnan and Thornton (2010) are unsure of the “purpose of marking all financial statements elements to their market values”. The case of Enron’s bad use of the market-to-market accounting is brought into discussion. Moreover Power (2010) conclude that if the financial statements and financial markets would perfectly reflect each other the accounting would out of use	The fair value accounting it is an important tool especially for those assets having attached a credit risk. “While the current accounting debate focuses on the implementation of FAS 157 and FAS 159, the fact is that even for loans, accounting has historically followed a pseudo fair value model. A pro-vision for credit losses is not technically fair value accounting; however, it has been accepted practice to write-down loans to a recoverable amount or the fair value” (Scott, 2010)
Many though argues that there was a large amount of lack of knowledge and information among all the actors that should act against the crisis effects such as managers, accountants, auditors, etc. (Fahnestock, Bostwick, 2011)	FVA details three possible assessment ways. First level is the liquid market price. The second level (when there is no liquid market available) is based on “close substitutes”. Level three assessment is a model-based one (a discounted-cash-flow for example) (FAS 157)
The usage of fair value accounting may be limited by asymmetries and complementarities in information (Bignon et al., 2009)	
The possibility of assessment the fair value based not on the quoted market prices (if they missing) but on the subjective assumptions, thus becoming manipulator and deceiving (Ryan, 2008)	

Among all the voices accusing the fair value accounting the main idea is that this approach alters the value of the assets or liabilities on subjective basis. It is also an issue for different kind of investors. If the value investors buy stocks selling at a discount to their FV waiting then for the FV of the investment to be achieved, the growth investors rely on earnings estimates too high or otherwise unreliable.

Also there are voices calling for a suspension of the mark-to-market accounting as a cure for the crisis, as it happened in the case of the Great Depression, when F.D. Roosevelt suspended it in 1938. The coincidence is interesting if we consider that FASB 157 was introduced in 2007, the very year of the eve of the crisis. The rule to write-down the loss even before it occurs brought panic and a pessimistic investment environment opening the way for the financial crisis. Yet these voices do not mention the fact that the investors were before that over enthusiastic and over optimists regarding their portfolios and the values boomed over any common sense edges.

The mechanism of the FVA shows us rather that it was introduced too late and not it is fundamentally wrong. If I purchase stocks for 100 Euros and the market value falls at the level of 50 Euros I have to report this in my financial statement. So, if the fair value approach would be implemented before I have done my investment, my very purchase could be in fact at the real value (50 Euros) and not at the over optimistic 100. The crash of my stocks occurs when due to the fall registered in my statements I go to the market and wish to sell my stocks. And of course I am not the only one wishing to sell these stocks. Flooding the market could also bring a fall of the value and an over optimistic investment made at the level of 100 is now liquidated at less than a half. And the crisis begins.

5. Conclusion

It is quite difficult to affirm that the financial crisis is definitely an effect of the fair value accounting or it was facilitated by extended use of it for valuation of financial assets and liabilities. Even so, the regulators continuously assess the users' needs and respond accordingly modifying and adapting the standards and guidelines.

Moreover due to the complexity of the crisis spreading phenomena it is difficult to say if the crisis had only financial causes.

In my opinion the fair value regime was introduce in moment when the values in the investors' pockets were highly over evaluated and over optimistic. It was enough one investor to change his position to trigger the falling apart of this over enthusiastic investment attitude. Another thing is that the FVA is based on the fact that the market is perfect and full of rational agents and no one is looking for quick benefits and speculates from the changing context.

It is interesting, I believe, if the fair value accounting will prevent further financial crisis by its risk based mechanism. It is also an issue the attractiveness of the financial market for agents wishing not to wait for a future more certain benefit but expecting to win speculating the rapid modifications in stock market value and even influence it.

The role in the crisis development debate is after all only one side of argue. The other one is oriented whether the fair value should be extensively used for non-financial assets, namely for property, plant and equipment.

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