

EMPIRICAL STUDY ON THE PROSPECTS OF APPLYING FAIR VALUE ACCOUNTING IN ROMANIA

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Abstract: *In this paper we have attempted an empirical research on the perception of accounting practitioners over an accounting system based on fair value. Through our empirical research activity we aimed to determine and analyze the options and prospects for applying various valuation basis within an accounting system, taking into account the fact that the international accounting regulations display an ever increasing interest for valuations based on fair value.*

Key words: *fair value, valuation, historical cost*

1. INTRODUCTION

Lately, under the pressure of investors and with help from the organizations involved in regulating accounting activities, we have witnessed a change of the traditional accounting model based on historical cost, which has turned into an accounting model based on the fair value, which would in turn meet the requirements for „maximizing share value” (Ionascu, 2003). The concept of just value has raised the interest of many theorists, practitioners, and organizations involved in regulating accounting activities, all of which have made contributions to defining it.

The increased importance of the concept of “fair value”, as well as the ever higher importance of financial assets, have created the framework for developing a new value-based accounting model.

But, the choice of the accounting system should take into account all categories of users for whom the financial statements are meant. And that is because the accounting reference system issued by the IASB has attracted an ever increasing number of critics from certain categories of users, who believe that the international accounting standards are meant mainly to the benefit of investors and fail to take into account the needs of other users or the realities within companies.

Although international regulating bodies aim to extend the practice of using fair value for the valuation of all the elements of the balance sheet, regardless of the companies’ field of activity, valuation systems based on fair value are still a rather controversial issue.

Thus, it is thought that the valuation of balance sheet assets for their fair value has a certain risk of manipulating results, because fair value is only an accounting estimate that leads to such behavior as creative accounting.

Of all the criticism expressed against fair value, the most consistent one come from insurance and bank specialists, who fear that, if they registered the loss of value of the assets relative to their market value, that would only increase the result’s volatility, and that would create panic among clients, which is a risk factor for these institutions (Hirst, 2004).

According to most empirical studies carried out in the American environment (quoted by Oung, 2001) valuating a bank portfolio at its fair value does not allow for a better explanation of the share rates for banks.

Under these circumstances, we can only wonder what the future holds for fair value in Romania. Will there be a new accounting system, based on fair value, or will there be a choice for a combination between the two systems? Four our country, the concept of fair value, as well as all the other amendments of the accounting system starting with the year 2001, are quite new. We still find it difficult to explain it as concept, and even more difficult to apply it to practice.

2. THE RESEARCH METHODOLOGY

In this paper, we have attempted an empirical research on the perception of accounting practitioners over the options and prospects for applying various valuation bases in order to improve the quality of financial statements.

As research procedure I have used a questionnaire that includes a pre-established set of questions designed so as to ensure the possibility of analyzing the opinions of the people who responded. Combined with the procedure of the questionnaire, I have also used the method of the survey, based on the use of a batch of people as research instrument. After choosing the batch, the questionnaire was e-mailed to the people chosen, and then I proceeded to process and analyze the data, in order to extract the information required to respond to the aims of this scientific research.

Our choice and outlining of the research area was justified by the following factors:

- The importance of choosing and applying the valuation bases used for establishing the value of the elements identified and registered in the accounting records, in order to improve the utility of financial statements;
- International accounting standards are placing an ever increasing emphasis on valuation based on fair value;
- Establishing the degree of practical application for the recommendations of national and international regulating bodies, with regards to the assessment of financial statements elements, can provide us with an image of the progressive path that valuation bases have taken as they evolved in their use in accounting systems.

Before establishing the working hypotheses that will be confirmed or not by the results of this research, we proceeded to establish the aims of this research, and they are as follows:

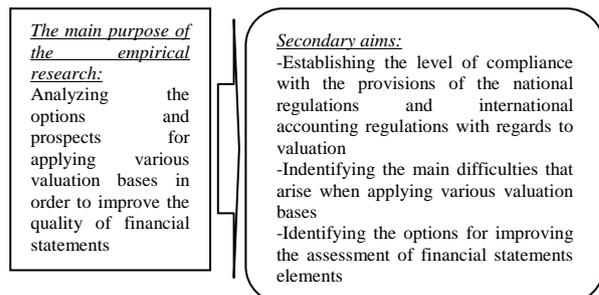


Fig. 1. Establishing the aims of the empirical research

3. CONCLUSION

By analyzing the answers that we received from the surveyed professionals, we may reach the following general conclusions with regards to the options and prospects for applying various valuation bases within an accounting system:

- The participants in the survey had very different opinions on the fact that *most companies use historical cost as valuation base in their accounting*, as half of them found this to be a normal thing and the other half dismissed it as abnormal, since historical cost doesn't reflect the prices applicable at the date when the financial statements are prepared.

- Most of the participants believe that *a regular re-valuation of assets* is necessary, but they admit that *conducting re-valuations depends largely on their fiscal regime*. In that which concerns the people who should handle the re-valuation of assets, the large majority of the survey participants answered that they believed *re-valuations should be handled by a valuator independent of the company*.

- The opinions concerning the need to extend valuation based on fair value to all the elements of the balance sheet vary largely, as this subject is strongly debated in specialized literature too, and there are an almost equal number of supporters and objectors to accounting systems based on fair value. In that which concerns the future of the relation between fair value and historical cost within the accounting system used by a company, most of the survey participants believe that, in the future also, a mixed system will be used, based on historical cost and fair value, and fair value will be used together with historical cost in some unique financial statements.

- Off all the difficulties that arise when applying other valuation bases than historical cost, the most important one is considered to be *the high cost involved by resorting to an authorized valuator*.

- *Using historical cost and prudence when calculating the distributable result and using fair value for calculating the global result* is the approach supported by the large majority of financial auditors, since this ensures that the "virtual" result generated by recording the latent overs and shorts resulting from a valuation based on fair value will not be distributed, as that might lead to a de-capitalization of the company; nevertheless, keeping two sets of accounts, one using historical cost and the other using fair value, isn't always a justifiable decision in terms of the cost to benefit ratio.

This empirical research based on a survey was built starting from a system of hypotheses, which were either confirmed or rejected after processing the statistical data and analyzing the data obtained from the research. In the table below (Table no. 1) we presented a summary of the working hypotheses established, outlining the decision whether to accept or reject them, as determined after each hypothesis was tested through the empirical research we conducted.

We believe that, both in Romania and at an international level, in the near future we will use a mixed type of valuation, characterized by using historical cost and fair value together. Fair value will be used mainly for drafting consolidated accounts, since they are meant almost exclusively for shareholders and managers.

Among the obstacles to adopting fair value, we have considered the following:

- in Romania, there still are regulations under effect that consider juridical and fiscal aspects as having priority to economic ones. That is why historical cost has been requested, and will be requested in the future too, as the value to be used when establishing the tax base, as far as fiscal regulations go, and organizing two sets of financial statements, both for historical cost and fair value, isn't always a good option in terms of the cost-benefits ratio;

- the imperfect economic conditions don't allow us to obtain market information;

<i>Working hypothesis established</i>	<i>The result after testing</i>
<i>1. Most companies use historical cost as a valuation base for the elements of financial statements.</i>	<i>Accepted</i>
<i>2. The re-valuation of assets should be done on a regular basis, to ensure an accurate image of the company's financial position</i>	<i>Accepted</i>
<i>3. The fiscal regime of re-valuations is a critical factor when conducting re-valuations.</i>	<i>Accepted</i>
<i>4. The possibility of an accounting professional conducting a re-valuation based on certain indexes would be an encouraging factor for conducting re-valuations.</i>	<i>Rejected</i>
<i>5. Valuations based on fair value should be extended to all the elements of the balance sheet only for the companies that are present on the exchange market, and for which the main users of the financial statements are the investors.</i>	<i>Rejected</i>
<i>6. Soon, a mixed system will be used, based both on historical cost and fair value.</i>	<i>Accepted</i>
<i>7. The confusion between fair value and market value makes it more difficult to apply fair value to practical purposes if there is no active market.</i>	<i>Accepted</i>
<i>8. Accounting norms don't provide a clear delineation between fair value and its applications or interpretations, so that fair value doesn't appear like a well founded concept.</i>	<i>Accepted</i>
<i>10. The high cost involved by using an authorized valuator is a factor that discourages the application of fair value</i>	<i>Accepted</i>
<i>11. Using historical cost and the principle of prudence for calculating the distributable result and using fair value for calculating the global result that would reflect the creation of wealth for the shareholders.</i>	<i>Accepted</i>

Tab. 1. Summary of the working hypotheses established

- the theoretical reflections on alternative valuating methods in accountancy and the concept of fair value are insufficiently developed (Deaconu, 2009);

- the accountant's mentality, as he refuses to adopt the new concept and accept the changing of a valuation system he is familiar and works easily with.

Obviously, there's also the issue whether the result obtained by including certain gains, resulting from the use of fair value as a valuation method, can or cannot be distributed, given that it's only a potential value. A solution would be using historical cost and prudence when calculating the distributable result and using fair value for calculating the global result, which would reflect the creation of wealth for the shareholders. Another solution is offered by Jose-Maria Roldan, (quoted by Huw Jones, 2009), who suggests recording latent gains in a reserve fund.

4. REFERENCES

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