

The Fair Value Controversy: Ignoring the Real Issue

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Abstract

In the context of the measures being taken to put an end to the current financial crisis, the extent to which fair value accounting can be blamed—or whether it can be blamed at all—for the intensification of the slump has been widely debated. This position paper shows that this debate, which ignores the real issues, has led to accounting changes that are at odds with their objectives. We examine the relevance of the accusations levelled at fair value and of the responses proposed in an attempt to improve the use of fair value accounting and make it more relevant to the economic realities faced by banks as well as by companies in general.

The critics of fair value accounting have failed to consider the problem upstream; that is, they do not first examine the role of accounting. As it happens, the objective of accounting is to provide as reliable a description as possible of the net assets of a company at a given time, in the environment prevailing at the moment of the statement of the accounts. The role of financial reporting is to act as a source of information; it does not have a prudential role. Although accounting doctrine has taken a more financial approach in recent years, accounting cannot replace financial and prudential analysis.

In an attempt to reduce the pro-cyclicality of accounting, some have advocated suspending fair value accounting or even doing away with it altogether. The October 2008 amendments to IFRS 7 and IAS 39 go in this direction, as they now make it possible, on certain conditions, to report at historical cost transactions that had previously been reported at fair value. In our view, this change is likely to hide the real risks to which companies are exposed and to increase the mistrust of the financial community, which will continue seeking information in fair value terms, as it did during the previous financial crisis early in the current millennium.

In 2002, as it happens, when accounting was done at historical cost in most European countries, the pro-cyclical nature of accounting rules had already been made clear: at the time, insurers had reported massive provisions for durable depreciation, forcing them to cede a great portion of their stock portfolios and to raise capital to maintain their solvency margins.

As early as 2006 our research showed the limits and the impact of certain accounting treatments adopted by the IASB. All the same, the accusations currently being levelled at fair value seem altogether distorted to us and as such cannot serve as a foundation for reflection on ways of resolving the crisis. That the measure of fair value and the accounting treatments adopted by the IASB are highly debatable doesn't necessarily mean that fair value accounting itself must be rejected. In our view, a return to accounting at historical cost would be mistaken; it would only prolong the crisis, much as it prolonged the Japanese banking and financial crisis.

Even though fair value accounting reveals a weakening of bank balance sheets, it is not the domain of accounting to estimate the need for additional capital and/or for a necessary curtailing of business. That is the role of the regulator. Accounting is but one of the available media, and the judgment of the regulators should also be founded on the ability

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The ideas and opinions expressed in this paper are the sole responsibility of the authors.

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of financial institutions to recover in the near future, on their real susceptibility to the crisis, and, more broadly, on their ability to manage the situation and turn it around. This prospective dimension is not the province of accounting.



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Introduction

The current credit crisis, triggered by losses on American subprime mortgages, has gradually turned into a global crisis of confidence. In October 2007, G7 finance ministers and central bank governors asked the Financial Stability Forum (FSF) to examine the causes of the crisis and make recommendations for managing it. Some of these recommendations (FSF 2008) dealt with accounting standards. The FSF recommended that these standards improve the treatment of off-balance-sheet items (for greater transparency), that they offer more guidance on the pricing of financial instruments in inactive markets, and that they require better information on pricing methods and on their sensitivity to the assumptions and parameters chosen.

In this context, then, a debate about the appropriateness of fair value accounting in times of crisis sprang up. This lively debate reflects, as it happens, the difficulty of valuing both complex and conventional financial instruments in inactive markets.

As the crisis worsened over the summer of 2008, the shoring up of the banking system and the protection of depositors became priorities. Governments worldwide intervened, and on 22 September (US Department of the Treasury 2008) the group of G7 finance ministers requested that the FSF recommendations be put into practice.

At the same time, the number of critics of fair value accounting has continued growing. They accuse it of being one of the causes of the amplification of the crisis. The two major grounds for complaint are its pro-cyclical nature and the insufficient information provided by the standard-setting bodies on the means of valuing financial instruments in inactive markets.

Their backs against the wall, the FASB and the IASB¹ raced to make amendments to their standards. On 30 September 2008, the SEC² and the FASB issued additional guidelines for valuing assets in inactive markets (US SEC 2008). On 16 October, the European Commission (EC regulation 1004/2008) adopted the IASB's amendments to IAS 39 and IFRS 7.³ The aim is to allow financial institutions (mainly banks) to lessen the impact of the current crisis on the accounts published as of the third quarter of 2008. For this purpose, the IASB is, on certain conditions, allowing certain financial instruments—loan-related securities among them—to be shifted to classifications for which the accounting treatment results in absence of volatility in the profit and loss account and perhaps even in the balance sheet (with the exception of durable depreciation).

The objective of this position paper is to show that the current debate on the relevance of fair value ignores the real issues and that amendments made in haste by the international standards-setting body are at odds with their objectives. We examine the relevance of the accusations levelled at fair value of the responses proposed in the light of the role of accounting; the aim is to improve the use of fair value accounting and make it more relevant to the economic realities faced by banks as well as by companies in general.

As it happens, the debate on fair value is distorted by an insufficient consideration of the role of accounting and by the confusion caused by provisions for the treatment of fair value adopted by the IASB (complex classification of financial instruments, fair value pricing methods in inactive markets, and treatment of fair value variations that are not yet perfected).⁴ Most of the criticism advocating the suspension or even

1 - Financial Accounting Standards Board (FASB); International Accounting Standards Board (IASB).

2 - Securities and Exchange Commission (SEC).

3 - IAS 39: Financial instruments: recognition and measurement; IFRS 7: Financial instruments: disclosures.

4 - This latter point is at the heart of our research and has been examined in several studies (Amenc et al. 2006; Foulquier 2007; Foulquier and Touron 2008).

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the suppression of fair value accounting seems to us unfounded, as many of its critics lump together the role of accounting and that of prudential regulations. If the aim is to lessen the oft-decried pro-cyclicality of regulation it would be more effective to adjust solvency capital requirements.

So, removing information from the books by suspending fair value accounting would not but exacerbate the current crisis of confidence. After all, despite the historical cost approach in favour during the financial crisis of 2002-2003, many insurers were forced to sell off a part of their stock portfolios, at the height of the gale, to put an end to the increase in provisions for durable depreciation. The insurers thus needed several injections of capital to restore their solvency margins. At the time, the pro-cyclical nature of accounting (at historical cost though it was) had already been pointed out.

To show that the debate on fair value ignores the real issues and has led to counterproductive amendments, we first review the role of accounting and examine user expectations (section I). In sections II.1 and II.2, we examine the relevance of the critiques of fair value in this time of crisis. We then show that the debate should focus not on fair value but on the choices for the accounting treatment of fair value adopted by the IASB (section II.3). Finally, by looking into whether the increased volatility of the profit and loss account is likely to call into question the relevance of treating it under IFRS (section III), we broaden the terms of the debate.

I. The Role of Accounting and Users' Needs

It is our belief that current debate on the share of responsibility for the current crisis borne by fair value accounting ignores the real issues, as it generally fails to acknowledge that accounting has a role as a source of information, not as a source of prudential rules.

I.1. Accounting Has a Role as a Source of Information...

Initially, accounting systems were developed to prevent corrupt practices by the managers to whom the shareholders delegate the management of their assets. In this respect, the role of accounting is to make possible the necessary oversight of management, that is, to ensure that they use the resources entrusted to them in accordance with their implicit contract (Gjesdal 1981; Jensen and Mekling 1976). In other words, accounting systems emerged to respond to a need for stewardship.

The literature on accounting also identifies accounting as a source of information, especially when it comes to valuing companies (Edwards and Bell 1961; Ohlson 1995; Barth 2000; Barth *et al.* 2001; Landsman 2007). Two schools of thought have thus grown up around the functions of accounting: the positive accounting theory and the information perspective accounting research.

For the positive accounting theory, accounting makes it possible for shareholders and creditors to ensure that managers are managing assets judiciously. It has a supervisory role. Many studies (Sunder 1997;⁵ Watts and Zimmerman 1986; Watts and Zimmerman 1990) have shown that there is an implicit relationship of agency in the accounting relationships of

the protagonists and that the introduction of contractual costs makes it possible to account for the existence and organisation of accounting systems (Ball and Smith 1991).

In the information perspective accounting research (Barth and Landsman 1995; Barth 1994; Barth 2007), accounting and thus the information it provides are considered useful if they have an impact on investment decisions, while they are considered relevant only if they reflect market value.^{6,7}

All the same, the dual accounting functions of supervision and information intersect, as it would be hard to publish the accounts without informing (Zimmerman 1997). So, in practice, accounting has a role as a source of information for its users;⁸ it should strengthen their capacity to make economic decisions and, as such, it should provide an economic evaluation of any entity in the environment prevailing at the moment of the statement of the accounts. It is then left to the users—with these financial summaries drawn up on information considered trustworthy and comparable—to attempt to forecast the future performance of the entity. **This prospective aspect is not a function of accounting.**

For the published accounts to play their role as sources of homogeneous, transparent, objective, and trustworthy information, they should, in our view, satisfy relatively strict requirements that cut down on the room for manoeuvre (creative accounting) and limit possibilities for differing interpretations in the preparation of the accounts. For improved comparability, published amounts should also be determined with a certain rigour and rigidity. To offset this rigidity,

5 - "Accounting and control provides mutually observable variables in terms of which shareholders' (and many others') contract is defined and made enforceable. In the absence of such a system, diffuse ownership of equity claims is not only inefficient, but also impossible. Claims that in an efficient market the accounting function is essentially limited to providing information about market risk and to explaining abnormal, firm specific returns miss the whole point of what accounting and control does in a firm" (Sunder 1997, p. 106).

6 - This theory is thus linked to the conceptual framework of the IASB and the FASB, even though the term "relevant" used in the conceptual framework can create confusion, as it encompasses the "useful" and "relevant" vision of the information perspective accounting research.

7 - An event study is usually used to gauge the impact on investment decisions, while an association study is used gauge relevance.

8 - In accordance with the conceptual framework of the IASB, the users of financial statements are present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public (IASB 2008 conceptual framework, paragraph 9).

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the appendices should include additional explanations of the amounts in the profit and loss statement, the balance sheet, and the cash flow statements. In this way, beyond the justification for these figures, sensitivity studies, simulations, and other stress tests should make it possible to provide a broad overview of the company.

In other words, the role of accounting is limited to a description as reliable as possible of the situation at a given moment (insofar as it can be described), including situations characterised by high volatility, as this volatility usually reflects disturbances in the environment of the company under consideration (*i.e.*, given a "faithful representation"). Removing this information on the pretext of lessening the pro-cyclicality of accounting would reduce transparency and deepen the crisis of confidence, which would result in an even greater increase in the risk premium. To believe that the financial markets would be altogether deceived is to underestimate their capacity for analysis. Uncertainty and the absence of transparency are always penalised by the markets. As we shall see, this pro-cyclicality should be managed by prudential regulations, perhaps by creating flexible capital requirements, as suggested by Sender (2008).

I.2. ... Not as a Source of Prudential Rules

In addition to the above-mentioned expectations of the users of the accounts, it seems important to us to point out the bounds of accounting with respect to these expectations.

As it happens, the objectives of IFRS and of fair value are to provide a clearer view of the risks, whether operational or financial, borne by companies. This accounting

approach also has the advantage of giving companies an incentive to map their risks and to measure their sensitivity to them with endogenous and exogenous data and ultimately to hedge them better.

All the same, although fair value may well be a great leap forward in the information provided by company accounts,⁹ this more "financial" approach **should not take the place of financial and prudential analysis, which should remain independent of the chosen accounting framework.** By no means should the arithmetic results of the accounting calculations take precedence over the evaluation of the risk profile of the company by investors, regulators, and financial analysts.

It is important to avoid mixing up genres: accounting reporting has a role as a source of information, and as such should indicate the value of the company at the moment of the statement of accounts.¹⁰ The aim of prudential regulations, by contrast, is to guarantee the stability of the financial system and to protect investors' deposits, and for this reason the prudential apparatus should provide a prudent value for the situation of the company, a value that includes expected losses in particular. It is worth mentioning that these accounting and prudential standards differ as well from internal risk management processes, the analysis of which—in an attempt to ensure optimal allocation of assets—is much more forward-looking.

It is our belief, then, that the current controversy over the relevance of fair-value accounting in times of crisis is linked to the demands of certain users—using as a pretext the improvement in financial information brought about by the IFRS move to fair value—for accounting to take on a role greater than it should. Some are tempted to

9 - 79% of the 2,006 members of the CFA Institute (the world's largest association of financial analysts) who responded to a survey reported that they thought that fair value valuation applied to the financial sector increased transparency and made possible improved readings of the risk profiles of financial institutions (<http://www.cfainstitute.org/memresources/monthlyquestion/2008/march.html>).

10 - Paragraph 12 of the conceptual framework of the IASB states: "The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions".

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consider accounting magnitudes without doing additional analysis, but, as we have seen, the role of accounting is simply to provide a snapshot of the situation of the company in the environment prevailing at the moment of the statement of the accounts. It says nothing of the future and cannot be the sole source of information as to overall financial health—this caveat is particularly true of banks in the current crisis. This analysis is not the province of accounting; it is a matter for prudential regulators.

I.3. The Measure of Fair Value: Price Versus Value

We have shown that the debate on fair value accounting ignores the real issues. Some critics of fair value, in addition to their improper consideration of the role of accounting, seem to lump together the suitability of fair value and the measurement of fair value. That the measure of fair value and the accounting treatments adopted by the IASB are highly debatable, however, doesn't necessarily mean that fair value accounting itself must be rejected.

When the measurement of fair value is discussed, a debate on the difference between price and value soon takes shape: are the accounts built on the basis of prices or of values? For our debate on the suitability of fair-value accounting for financial instruments, it is important to underscore at the outset that this fair value does not exist intrinsically, that it is the result of a theoretical approach (Bernheim and Escaffre 1999). In fact, fair value is defined by the IASB (IAS 32, paragraph 5, and IAS 39, paragraph 8) as the amount for which assets or liabilities could be

exchanged between knowledgeable parties in an arm's length transaction. So, in a strict sense it is a price and not a value. This absence of distinction has often been the source of unfounded criticism (see section II).

Keynes's (1936) general theory defines the value of an asset as the value resulting from discounting the cash flows generated by ownership of the capital asset, that is, its intrinsic value. Price, on the contrary, can be defined as the outcome of the law of supply and demand. Although it is based on the value of the company, it depends on subjective, not always quantifiable elements, such as the negotiating power of the buyer and of the seller, their relationship, the personality of the parties, their desire or obligation to complete the transaction, the interest in the transaction of the parties to it, and so on.

So, when there is a perfect and complete market, market value is fair value. When the market is imperfect, by contrast, the size of the market, the liquidity of the market, counterparty risk, management intentions, financing costs, risk aversion—in short, all the particularities of those involved in the over-the-counter markets—must be taken into account when fair value is determined.¹¹

IAS 39 (paragraphs AG 74 to AG 81) outlines the principles for valuation in the absence of an active market. Fair value, in fact, is a notion of value that should be associated with a methodological approach whose aim is to provide a neutral¹² and objective valuation. By no means, however, does this neutrality or objectivity of valuation exclude professional judgment.¹³ The relevance of these valuations rests on the sincerity

¹¹ - Barth and Landsman (1995) deal with fair value in perfect and imperfect markets:

- when the market is perfect (liquid, active, and organised), fair value is equivalent to market value. The balance sheet includes all the information useful to a valuation of the company. It is assumed that management and the market are capable of ascertaining all the elements of the asset and of assigning them a "fair value." Under this assumption, the observation of an income is not necessary to the valuation of the company.

- when the market is imperfect, it is necessary to determine a value with a method whose reliability must be proven.

¹² - The principle of neutrality is enshrined in the IFRS conceptual framework (paragraph 36).

¹³ - IAS 39: Financial instruments: recognition and measurement: "A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument".

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of the assumptions and the diversity of the methods. The transparency of these assumptions and estimations—through detailed information in appendices—is meant to ensure credibility and make the published accounts comparable.

For the creators of the standards, valuation techniques should incorporate the observation of recent arm's length transactions between knowledgeable, willing parties,¹⁴ the reference to the current fair value of another materially identical instrument,¹⁵ or the analysis of discounted cash flows associated, if necessary, with stochastic valuation models. The computation of a value grounded on discounted cash flows is a method that leads to determination of a use value, which, in the total absence of benchmark values, is fair value.

If the market has a commonly used technique to value the instrument, and if it has been proven that this technique generates reliable estimates of the values obtained on the real market, the entity should use this technique. As a result, entities are called on to identify acknowledged best practices.

Let us underscore, finally, that an entity should, by incorporating, if necessary, observations of current transaction prices for the same instrument on perfect markets or on over-the-counter markets, periodically revise its valuation assumptions and techniques to ensure that they remain valid. If there is no observable parameter for construction of the model, the entity is obliged to present its sensitivity tests.

On September 16, 2008, in response to an unprecedented financial crisis, the IASB expert advisory panel published a draft entitled "Measuring and disclosing the fair

value of financial instruments in markets that are no longer active" (IASB 2008a). This panel was formed by the IASB in response to a request from the Financial Stability Forum. The panel's work was ratified by an October 31 publication (IASB 2008d) that makes recommendations for the determination of fair value.

This draft has two parts, the first of which deals with measuring value. The second part deals with disclosure and sets the stage for possible modifications to IFRS 7 (Financial instruments: disclosure). This project was followed by the October 13 and 14 publication of amendments to IAS 39 and IFRS 7 (IASB 2008b, 2008c).

This panel examined inactive markets. In such markets, entities must acquire a complete and reliable understanding of the instrument that is subject to a measurement of fair value by considering all the available relevant information. Information to be considered includes:

- prices from recent transactions in the same or similar instruments (IASB 2008d, paragraphs 37–46)
- quotes from brokers and pricing providers (databases) (IASB 2008d, paragraphs 52–74)
- indices and other input to model-based valuation techniques (IASB 2008d, paragraphs 47–51).

If information on prices is unsatisfactory because it comes from a totally disorganised or inactive market, a mark-to-model valuation should be used. So, in inactive markets, an entity should determine its best estimate of fair value within a documented range of measurements that should be grounded on the following:

- measurement on the basis of a recent transaction in an active market in the same financial instrument
- measurement of fair value on the basis

¹⁴ - In accordance with the definition of fair value (IAS 32, paragraph 11).

¹⁵ - In practice, many financial institutions use, for example, the hypothetical derivative method to value their hedging derivative instruments such as swaps (interest rate) or caps and floors.

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of the valuation of a similar financial instrument

- modeling on the basis of observable or unobservable input.

But **fair value is not the amount the entity would receive or pay in a forced transaction or liquidation.** Moreover, on October 10, 2008, the expert advisory panel pointed out that transactions at fire-sale prices should not be made part of fair value assumptions. Fair value is the value of a transaction realised in normal conditions, not as part of a distress sale or a forced liquidation. All the same, the panel emphasised that not all transactions realised during the current crisis were necessarily equivalent to forced liquidations undertaken at fire-sale prices.¹⁶

Some specialists have suggested that when market prices are set during crises (a plunge in stock prices, a jump in interest rates) a "fundamental-value" approach, grounded primarily on estimates of future cash flows easily assimilated to the determination of a use value, should be used to determine fair value. The IASB panel pointed out that "fundamental values" are at odds with the objective of the measurement of fair value, in particular because they fail to take into account the risks linked to these cash flows.¹⁷

Fair value accounting, then, is inseparable from expanded reporting of information, that is, the design of financial statements that leave plenty of room for qualitative information to explain whether fair value stems from a market value or a model value. The underlying principle is that financial transparency reduces doubt and promotes investor confidence in published accounts.

16 - "The objective of a fair value measurement is the price at which an orderly transaction would take place between market participants on the measurement date; it is not a forced liquidation (i.e., forced transaction). Even when a market has become inactive, it is not appropriate to conclude that all market activity represents forced transactions" (IASB 2008d, paragraphs 21-22).

17 - "However, fundamental values are not consistent with the objective of a fair value measurement because they do not take into account factors that market participants would consider when pricing the instrument, such as illiquidity and credit risk. [...] Accordingly, a value measured using a 'fundamental value' approach might not represent an estimate of a current transaction price" (IASB 2008a, p. 3).

II. On the Relevance of the Criticism Levelled at Fair Value in this Time of Crisis

II.1. Is Fair Value Pro-Cyclical and has it Exacerbated the Crisis? Is the Smoothing or Suspension of Fair Value Relevant?

One of the most virulent critiques of fair value accounting has to do with its purported pro-cyclicality (Bloomfield *et al.* 2006). The Financial Stability Forum asked the IMF to analyse the pro-cyclical features of fair value (IMF 2008). Although the goal of the study was not to cast doubt on the notion that fair value increases the volatility of the financial markets, the IMF (on the strength of a report on sixteen US and European banks in 2007) noted that fair value improves financial transparency if the issuers are capable of providing relevant information on risks. So, the pro-cyclical nature of fair value may be curbed not only by the information from the risk pillars of Basel II, but also by the sensitivity tests on the valuation models used by the entities. In addition to these sensitivity tests, information on liquidity, credit, market and operational risks may be added in appendices. This is in fact the goal of the amendment to IFRS 7 (October 2008), drawn up in accordance with Basel provisions.

In addition, the IMF points out that it is mainly the incompatibility of accounting treatments for assets and those for liabilities that leads to pro-cyclicality. Finally, it warns that smoothing techniques and the reclassification of assets (especially from categories valued at fair value to those valued at historical cost) are likely to create incentives for excessive risk-taking (fair value on the upside and historical costs as a crash barrier on the downside), to prolong the effects of the crisis, and ultimately to lead to mistrust of financial statements.

Our analysis of the criticism that would blame fair value accounting for exacerbating the crisis sends us back to the role of accounting.

This crisis has spotlighted the close interaction of risk valuation models, risk management, and prudential regulation: in response to the fall in the prices of assets, especially for structured and securitised products, financial institutions have been forced to modify their risk exposures, to raise capital, and/or to sell assets to comply with solvency regulations, obligations that have kept markets down or even exacerbated their fall.

At the same time, given the role of fair value accounting as a source of information (offering users of the accounts a snapshot of the financial statement and of the variation in net assets at the moment of the statement of the accounts and in existing market conditions), it is up to the users to determine the suitable risk premium.

In our view, the criticism levelled at fair value as a result of its purported pro-cyclicality shows that some would like accounting to be both an instant snapshot of the real situation of bank finances and an indicator of the capacity of these banks to turn things around.

Although the fair value accounting may cause drops in the totals on bank balance sheets, we nonetheless believe that it is not the province of accounting to determine the extent to which this fall should lead to a call for additional capital or a curtailment of business. It is for regulators to do their own analysis of the accounts, to be sure, of the ability of the bank to right the ship, as it were, in the near future, of its real vulnerability to the crisis, and, more broadly, of the quality of management.

II. On the Relevance of the Criticism Levelled at Fair Value in this Time of Crisis

So the problem here is not the accountant's but the regulator's! The accusations levelled at fair value accounting are not a valid pretext for doing away with it. Some users of the accounts confuse the roles of the regulator and the accountant, or they want to have accounting expand beyond its borders: **the objectives of prudential rules and of accounting are not identical.**

The many arbitrage opportunities responsible for the current crisis (such as the low capital requirements for off-balance-sheet instruments leading to a *de facto* underestimation of the risks associated with them or the absence of harmonisation from one country to another for the determination of available capital [and even from tier 1!] leading to solvency ratios that vary by as much as 300% depending on the bank's home country) are the dominion of prudential rules, not of fair value accounting.

The problem we point to here is that of the consistent valuation of financial instruments under accounting, prudential, and in-house standards. How to have the same amounts when, as we mention in section I.2, they do not correspond to the same objectives?

So, in view of the role of the accountant as described above, one may well look into the relevance of the proposed solutions. We believe that smoothing fair value over six months (or even over a year), as proposed by three members (Zielke, Starkie, and Seeberg 2008) of the European Financial Reporting Advisory Group (EFRAG),¹⁸ and that suspending it in favour of a temporary return to historical cost would make little sense, as these solutions are likely to hide companies' real exposure to risks and to

amplify financial markets' mistrust without necessarily preventing pro-cyclicality, as was made clear by the behaviour of insurance companies in the previous stock market crash.

These revisions would give more room for interpretation both to banks that draw up their accounts and to the users of these accounts. In the current climate of scepticism, the feeling that the accounts no longer reflect market or economic reality would lead to greater suspicion that banks were underestimating the gravity of the crisis.

If the rules are made less strict or otherwise changed, we think that these changes should take place in prudential regulation (as occurred for British insurers during the financial crisis at the beginning of the millennium). Accounting must maintain its role as a source of information on the financial situation at a given moment, at the risk of creating additional confusion.

Nonetheless, the critics of the pro-cyclicality of fair value were so vociferous that in early October 2008 the IASB ultimately gave ground: it recommended modifying the fair value approach in inactive markets by making it possible, on some conditions, to reclassify certain assets. Let us recall that until then IAS 39.50 prohibited reclassifying any assets reported as held for trading. These amendments involve the following changes:¹⁹

- Assets (shares and debt instruments) other than loans and receivables, hitherto in the held-for-trading category, can be reclassified as available for sale (AFS) or as held to maturity (HTM)—shares, of course, can still not be classified as HTM—in extraordinary circumstances (IASB 39.50.B).²⁰ However, this amendment

¹⁸ - In an article in the Financial Times (Tidström and Enevoldsen 2008), the president of the EFRAG and the rest of its members nonetheless distanced themselves from this isolated position.

¹⁹ - Publication of the amendments to IAS 39 and IFRS 7 for the reclassification of financial assets on October 13, 2008. The EFRAG approved the amendments on October 13 and the European Commission adopted them on October 16, 2008 (date of publication in the Official Journal of the European Union, CE regulation no. 1004/2008).

²⁰ - As it happens, the IASB acknowledges that the current crisis may be considered an extraordinary circumstance of the sort for which IAS 39.50.B offers these provisions.

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excludes the reclassification of derivatives and assets reported under the fair value option (a significant share of the insurance sector assets not classified as AFS). Reclassification in held for trading remains prohibited.

- Assets in the held-for-trading or AFS categories can be reclassified as loans and receivables if they are in fact loans and receivables (that is, non-derivative assets with fixed payments, not listed on an active market, and free of a risk of substantial losses not linked to the deterioration of credit risk) on the reclassification date and the firm is willing and able to hold them for the foreseeable future or until maturity (IAS 39.50.D and E). Most loan-related securities (ABSs or CDOs for instance) can thus be reclassified as loans and receivables.

Reclassifications must take place at fair value of the assets on the date of reclassification. This fair value also becomes the new acquisition cost and prohibits the reporting of any income gains and losses that took place prior to reclassification.

These amendments have a dual objective:

- to allow banks to lessen the impact of the current crisis on their third quarter accounts
- to avoid competition distortions with American companies by reducing the number of differences on reclassification standards in US GAAP and IFRS (SFAS 115, FASB 1993).

Beyond the critiques formulated by banks and insurers (the absence of reclassification of assets recognised under the fair value option keeps in place a divergence from American practices, especially for certain structured products (like synthetic CDOs for example) for banks and for embedded derivatives for insurance companies: the carrying forward of depreciation on stocks

and the criteria for making insurance company assets eligible for HTM are not dealt with), we have commented extensively on our view:

- historical costs require the application of provisions for durable depreciation
- markets will not be hornswoggled by this change of method and will demand more market value and/or be more suspicious as reporting becomes murkier.

It is worth noting, finally, that from a prudential point of view this reclassification will not take place without an impact on the solvency margin. According to IFRS, certain financial instruments (certain CDOs, for instance) initially classified as held for trading are reclassified in the third quarter of 2008 as loans and receivables, in accordance with the amendments to IFRS 7 and IAS 39 adopted by the European Commission on 16 October 2008. The translation into prudential terms of this accounting reclassification results in the reclassification of the trading book as a banking book. And, as counterparty risks are explicitly taken into account, capital requirements are greater for the banking book than they are for the trading book.

It is our view then that this reclassification is more of a psychological boost—in response to a broad desire to restore confidence to the markets—than a real means of emerging from the crisis.

II.2. The Relevance of the Criticism of the Measurement of Fair Value

The use of fair value in IFRS accounts is part of a broader movement to improve financial reporting, increase transparency, and facilitate the swifter recognition of real risk exposure; the ultimate aim is improved corporate management and greater market discipline. Regulations having to do with

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the workings of the capital markets or with the oversight and solvency of financial institutions have also evolved in an attempt to achieve this aim. The last two decades then have seen a profound shift in the ability to identify, value, and manage risks through the generalised use of risk measurement and management tools (VaR, stress testing, control and governance structures).

The current crisis is a life-size test of these valuation and oversight mechanisms and has sparked much criticism of the suitability of valuation methods in extreme situations and as such of the relevance of fair value accounting.

In addition to the quality of valuation processes (robustness, exhaustiveness, and rigour), critics have zeroed in on the complexity of valuing sophisticated structured loans, especially on the underestimation of liquidity risk and on the excessive dependence on rating agencies, on primary market valuations and on historic data for volatility, rendered obsolete in such an environment.²¹ Mistrust of this measure, combined with very heterogeneous and thus largely incomparable reports, heightened uncertainty as to the location of risks and the illiquidity of the markets. The spread of these uncertainties to numerous markets led ultimately to the global crisis of confidence.

Although we share the belief that fair value should be subject to modification (greater convergence and transparency of methods in the absence of deep and liquid markets²²), calling into question the relevance of fair-value accounting is, in our view, inappropriate. Fair value has made it possible to gauge the extent of the crisis more swiftly (accounting at historical cost would very likely have detracted substantially from

this gauging of the crisis). It thus makes it possible to better calibrate drastic (or even exceptional, as we are seeing now) responses to the crisis. By contrast, accounting at historical cost in Japan is often accused of allowing companies to smooth or even conceal their real exposure and thus of having contributed to a slowdown in the recovery from the crisis, which lasted more than ten years. In addition, it is often said that the financial scandals of recent years or even the US savings and loan problems in the early 1990s could have been resolved more quickly and in a less costly fashion if fair value accounting had been used (Michael 2004; Jackson and Lodge 2004);²³ after all, correlatively to the implementation of efficient corporate governance, it is harder to engage in reprehensible accounting manipulations.

In a period of crisis, market prices no longer reflect systematically the future cash flow-generating capacity of assets, that is, future returns; they may reflect instead existing market liquidity (Plantin, Sapra, and Shin 2008). It seems advisable to us then to provide this complementary information and/or to resort to harmonised and detailed (valuation method, input and parameters used, especially assumptions about liquidity, counterparty, and model risk, sensitivity) mark-to-model pricing or even, ideally, to price this liquidity component (Allen and Carletti 2008) independently of the fundamental value of the assets rather than hide reality behind figures expressed in historical costs.

So, it is our view that the critics of fair value have once again missed the mark. **The underlying problem is instead that of the clarification of certain IASB accounting treatments.**

21 - VaR is grounded on the assumption of normal return distributions, makes inadequate allowances for extreme risks, and is sensitive (reduction) to low volatility (characteristic of the credit markets before the crisis). A reduction in VaR leads to a freeing up of capital and thus to the taking on of additional risk. The generalised adoption of VaR by financial institutions, fostered by prudential rules, has amplified pro-cyclicality. Finally, this phenomenon was sped up by the development of the originate-to-distribute model.

22 - In a crisis of confidence such as the one we are experiencing, model risk is often at the forefront (the risk of mistakes caused by unsuitable techniques or untenable assumptions). The use of theoretical models with often unobservable data leads to great subjectivity and possibly to asymmetries of information that create problems of moral hazard.

23 - Accounting at historical cost made it possible to conceal, among other things, that the US savings and loans offered variable rates higher than the profitability of the fixed rates of their mortgage assets.

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In the absence of definitions clearly stated by the IASB, financial institutions have not interpreted in the same way the elements that permit the use of the mark-to-model approach or even the appropriate time to do so, varying interpretations that have heightened feelings of uncertainty and created suspicions of accounting manipulation. Some banks prematurely adopted mark-to-model pricing in an attempt to limit the accounting depreciation that would have been reported by considering the market prices. This problem of interpretation, however, is hardly likely to validate the rejection of fair value accounting.

The real problems are the following. Many collateralised debt obligations (CDOs) and asset-backed securities (ABSs) were created to respond to the demands of particular investors. It is not in their nature to be exchanged, and it is hard to come up with a transaction price for them. More broadly, with the drying up of the liquidity of many complex and even conventional financial instruments, transaction prices on both primary and secondary markets become both unavailable and unobservable. Basing fair value on sporadic transactions on thin markets is unrealistic. To what degree should one consider fair the value of a rare and single transaction on an illiquid market? And what criteria should one use to drop mark-to-market fair value pricing in favour of mark-to-model pricing? What changes can be envisaged to make the measure of fair value more consistent (additional information on its volatility, its sensitivity, the extension of IFRS 7²⁴)? Is the FASB's three-category approach suitable and should it be broadly adopted?²⁵ And how too to define and frame mark-to-model pricing so that it does not become mark to myth?²⁶

In examining one of the causes of the financial crisis, it is worth noting that for many CDOs, tailor-made for particular investors, there was no secondary market. What then is the fair value of these CDOs, keeping in mind the absence of a market and the asymmetries of information between the banks that create them and the investors who acquire them? For the banker, fair value can be based on that of the components of the CDO and is thus the province of a price-forming mechanism linked to hedging (static or dynamic). Although the underlying models are known and acknowledged banking practices, they require assumptions specific to each institution, and for this reason there cannot be a unique fair value. **As a result, the unique value advocated by the IASB proves—in the absence of active markets—to be a myth.** In addition, the IASB, confronted with this heterogeneity of approaches, has since strengthened its recommendations having to do with the allowances made by valuation models for model risk, liquidity risk, and counterparty risk.

So, in this absence of active markets (some CDOs are tailored for particular investors), it is worth asking the following key question: how is it possible that putting these products in the trading book is allowed (by accounting standards and most of all by regulators)? Banks were given an incentive to make this choice by capital requirements that are lower in this category than they are in the banking book. The calling into question of fair value is thus altogether out of place, as the problem here is the opportunistic arbitrage of prudential regulations by banks! By making the gaming of prudential rules grounds for calling into question the relevance of fair value in accounting standards, there is yet another mistaken identification of the source of the problem.

24 - IFRS 7 (Financial instruments: disclosures) requires sensitivity analyses for broad risk categories but not for specific asset classes. American standards do not require reporting of sensitivity.

25 - The American FAS 157 requires three levels of valuation depending on market conditions: observable prices for the same instrument when markets are liquid; prices in the near future or for comparable instruments when observable prices for the same instrument are unavailable; detailed mark-to-model pricing if the previous two are unavailable.

26 - Warren Buffett, in his letter to his shareholders in the 2003 annual report, says: "In extreme cases, mark-to-model degenerates into what I call mark-to-myth".

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In other words, in our view, the debate on the relative suitability of fair value and other approaches to accounting (historical cost and use value) is often distorted because it ignores the real issues: the role of accounting (especially with respect to that of prudential regulation) and the measure of fair value (the difference between price and value) have been neglected.

In short, we take sides with those who, much as Churchill said of democracy, believe that fair value, though not without room for improvement (see section 11.3.), is the worst system, except for all the others; the others are less informative, are ill-suited to comparisons, and facilitate smoothing and discretionary management of the accounts.

II.3. Necessary Changes to the Accounting Treatment of Fair Value, Independently of the Crisis

Although we are in favour of maintaining fair value even during crises, EDHEC studies (Foulquier and Touron 2008; Foulquier 2007; Amenc *et al.* 2006) have underscored that regardless of current turmoil fair value accounting standards should be rewritten especially if the aim is to meet the IFRS objectives for improved perception of risks.

When financial firms are considered, the processing of IFRS accounts sometimes—and for some of the parties involved—seems to lead to opacity greater than that caused by domestic accounting standards at historical cost. This is the result not of fair value but of the following contradiction: the aim of IFRS is to encourage companies to manage their risks better, including their long-term risks, but the result of this aim in accounting terms is a quarterly

analysis in the change in their market value, which usually reflects short-term risk premia. It implies considering these longer-term commitments (assets or liabilities) on the basis of a permanent liquidation of assets and liabilities, in particular hedges (Foulquier and Touron 2008).

Criticism of IFRS and of IAS 39 is founded on the increase of accrued volatility in the profit and loss, which sometimes reflects movements different from those taking place in economic reality. For example, Foulquier (2007) and Amenc *et al.* (2006) show that if (in an environment of excessively low interest rates such as that of 2004) an insurance company hedges against the risk of a drop in interest rates to achieve an economically perfect asset-liability match, it may need to charge accounting losses to the profit and loss when the rate environment improves (when rates increase).

Take, for example, a life insurance company whose liability consists of a payout of €5,567 million in real terms in twenty years. The company wants to hedge its interest rate risk and to do so it uses a cash flow matching strategy to inoculate the current value of its liability²⁷ against changes in inflation rates and interest rates. This hedging strategy involves the purchase of zero coupon bonds of a nominal value of €5,567 million and a return of 4.51% over twenty years as well as an inflation swap.

If the economic situation improves and forecasts for inflation are revised from 2.9% to 2%, and interest rates from 4.51% to 5%, the construction of the strategy ensures that, for the insurer, the financial impact of the economic situation is neutral (a perfect match of assets and liabilities).²⁸

27 - We assume that the company forecasts an inflation rate of 2.9% and that the discount rate is 4.51% when the strategy is put into place (on January 1, 2008, for example). The discounted value of the cash flows in 2008 is thus $5,576 (1+2.9\%)^{20} / (1+4.51\%)^{20} = €4,088$ million.

28 - The new value of zero coupon bonds is $5,576 (1+2.9\%)^{20} / (1+5\%)^{20} = €3,723$ million

The market value of the swap is $[5,576 (1+2\%)^{20} - (1+2.9\%)^{20}] / (1+5\%)^{20} = -€600$ million.

The value of the assets (zero coupon + swap) is thus €3,123 million.

The value of the liabilities is $5,576 (1+2\%)^{20} / (1+5\%)^{20} = €3,123$ million. By construction, then, there is a perfect match of assets and liabilities.

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Because international financial reporting standards in no way reflect the real economic situation, the accounting impact is not neutral at all.

Indeed, as a swap is a derivative instrument, the changes in its value from one period to the next affect the profit and loss (-€600 million). As the zero coupon bonds are held until maturity as part of the hedging strategy, it is classified as an asset available for sale (the held-to-maturity category is infrequently used by insurers, who deem it excessively restrictive). Changes in the value of the zero coupon bonds have a direct impact on the balance sheet (without affecting the profit and loss); and imply a loss of €370 million (4,088-3,723). Finally, insurance liabilities subject to the 2005 to (at least) 2011 phase 1 of IFRS 4 are reported at historical cost and their change in value of €970 million has no impact on either the profit and loss account or the balance sheet.

In the end, although the environment is better for the insurer and its hedge is efficient (the change in interest rates and inflation rates does not affect the financial situation of the company), the insurance company falls victim to entirely artificial accounting volatility, in no way linked to economic reality, in its profit and loss accounts.

After all, the company must charge a €600 million loss linked to the hedge to its profit and loss and a €970 million loss to its shareholders' equity. It should be emphasised as well that if the company had not hedged, the reduction in its shareholders' equity would have been only €370 million. So the application of IFRS (when hedging risks with derivatives) not only inflates disproportionately the volatility of figures in financial reporting,

but it also penalises the companies that hedge, an outcome that is altogether at odds with the objectives of these reporting standards.

The publication of the semester results of CNP in 2006, subsequent to our work, is a very concrete illustration (*in vivo*) of the problem.

In general, it is our conviction that the contribution of fair value to the information made available to users of the books should not be confused with the IASB's choice of the mechanisms to reflect that information. In other words, it is the accounting distortions²⁹ (treatment of assets at market value and of many financial firm liabilities at historical cost, treatment of hedges, classification of assets into three categories with an excessively differentiated impact on the profit and loss and/or the balance sheet, and so on) that make fair value accounting murky and complex.

The current crisis is likely to be a real test of IFRS in a period of turmoil, and we think that this turmoil will provide further evidence for our criticism of the choices made by the IASB.

29 - In this respect, it is worth recalling that the temporary measure planned initially for three years (from 2005 to 2007), consisting of keeping most assets at market value and most banking and insurance liabilities at historical cost, is still in place (and will be until 2011). We believe that this choice is one of the major sources of pure accounting volatility—volatility that in no way reflects economic reality—in the profit and loss of firms in the finance industry.

III. Does the Volatility of the Profit and Loss Account Call Into Question the Relevance of its Treatment Under IFRS?

The current crisis is a life-sized test in extreme conditions. Although it raises prudential rather than new accounting problems, it does highlight or even accentuate the topicality of the EDHEC research programme entitled "The Impact of IFRS on Company Valuation".

As it happens, most of the criticism of fair value for financial instruments is centred on the volatility it causes in the profit and loss. The IASB's October 2008 amendments, allowing banks to put financial instruments initially classified as held for trading in the held-to-maturity or loans and receivables categories, are part of this attempt to reduce volatility. As a result of this amendment, changes in the value of newly reclassified financial instruments affect neither the profit and loss nor the balance sheet; in accordance with the principles of historical cost ...except when provisions for durable depreciation are needed.

Nonetheless, as we have mentioned, the current rise in volatility, often of a purely accounting nature and unconnected to economic reality, raises the matter not, in our view, of a return to historical cost, which would worsen the quality of information, but of the accounting treatment of fair value. Is the complex classification proposed by the IASB in IAS 39 relevant? Would the IASB's proposed merger of the available-for-sale and held-for-trading categories lead to clearer information or would the consequent treatment of certain liabilities at historical cost exacerbate existing accounting distortions?

Ultimately, the underlying issue is to determine whether all latent variation should be recognised directly in the profit and loss. But in that case, there is a risk of reducing the readability of the operating performance or even, as is happening

today, of changing the operational and financial strategies of companies, in an attempt to manage efficiently the profit and loss account, earnings per share, and profitability. Farther upstream, the issue becomes: **what are the role and the usefulness of the profit and loss account in financial reporting?** Broadly, fair-value accounting of financial instruments has led the drafters of international standards to reflect on a possible new context to describe performance in financial reporting.³⁰

Currently, fair value valuation of the profit and loss involves assuming that assets and liabilities can be exchanged or settled at any time. It therefore provides information on the transactions that could have taken place: it is no longer necessary to observe a realised transaction to confirm, in accounting terms, its "current" cost.³¹ The consequence is that if all financial instruments were valued at fair value, the variation in equity capital (with the exception of transactions on equity and distribution) would express variation in net assets at a given moment, that is, the performance of the company during an accounting year.

However, once the variation of a financial instrument is posted directly in the balance sheet, without affecting the profit and loss account, one may then wonder whether the profit and loss account (especially when the company is a bank or insurer) sheds any light on the real performance of the company. In addition, since changes in financial instruments, like exchange rates or interest rates, are not always entirely under the control of the company, confusion of the result linked directly to management decisions (and thus performance) and that linked to market variations is created.

30 - In its conceptual framework, the IASB has replaced "result" with "performance".

31 - This is an authentic break from the domestic accounting standards in most countries. For most of them, as in France, "only the earnings realised by year-end may be reported in the profit and loss account of that year". In domestic standards, the profit and loss account is then a statement of accounts limited to realised operations. Such an aggregate is unlikely to provide a complete view of the performance of the company.

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Mindful of this confusion, the international standard-setting body is weighing replacing the profit and loss account with a synthetic statement—so-called comprehensive income—representative of the overall profit and loss but more likely to capture the performance for the year (Escaffre and Ramond 2005). To improve transparency, all while allowing companies to present their performance in accordance with their modes of management and showing in a single table realised and unrealised gains (deviation from fair value impacting equity capital and the profit and loss account), the presentation of this statement has two components:

- one having to do with the conventional accounting profit or loss associated with realised transactions
- the other having to do with unrealised gains or losses (statement of equity movements not including shareholder contributions or redemptions).³²

In response to this issue of accounting doctrine, let us recall that in the conceptual framework it is spelled out that financial reporting should include information on the financial position, on performance, and on changes in the financial position of an entity, information that will help a wide range of users make economic decisions (IASB, IAS/IFRS conceptual framework, paragraph 12). Reflection on the depiction of performance, in short, is indispensable to the reliability and relevance of financial reporting.

From a theoretical perspective, the cycle of the depiction can be described in the following ways:

- interpretation of reality through economic transactions (invoicing, transfers, and so on)
- depiction of this reality (valuation, reporting of revenues and expenses)

- presentation of financial reports on the interaction of interpretation and depiction.

So the quality of the accountant's reading of performance depends on the quality with which this cycle is completed: performance measurement is an intellectual construct, not an observed fact, as the depiction of performance is made fully clear by the opinions formed of it by those for whose use it is intended (decoding of financial information). At this point, there are two opposing schools of thought: the current operating concept and the all-inclusive concept.

The current operating concept involves reporting only ordinary transactions from the current period and reporting any value changes not having to do with operations directly in the balance sheet. In the United States, for example, SFAS 52 requires that gains or losses on currency conversions be charged to shareholders' equity. In the province of business operations are usual, recurring events that make it possible to predict the future results of the company. For its advocates, this restrictive method facilitates inter-firm as well as inter-period comparisons. The idea is to report only those elements that are controllable by management; performance is evaluated with the accounting profit or loss. This dual approach to the profit or loss (as opposed to the single approach of the all-inclusive concept) is interesting, as the observation of the demands of the users of financial statements led to its creation. In response to two kinds of demands, two kinds of performance measurement have been described:

- a measure of the transactions completed by the company, reflected by the difference between revenue and expenses

32 - IAS 1 was revised on September 6, 2007 (presentation of financial statements). It will come into force for the periods opening as of January 1, 2009. The preparers of financial statements will have the choice of presenting revenue, expenses, and other elements of the overall result either in a single report (overall result will be made up of subtotals) or in two separate reports (a profit and loss account and a report for overall income). "Other comprehensive income" includes revenues and expenses (including re-measurements resulting from reclassifications) that are not charged to the profit and loss account, in accordance with the compulsory or optional provisions of the other IFRS reporting standards. So "comprehensive income" corresponds to all non-owner changes in equity. Comprehensive income for a period includes profit or loss and other comprehensive income recognised in the period.

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- a measure of change in net worth reflected by the difference between its net assets at the beginning and at the end of the period.

The all-inclusive concept, by contrast, takes into account the totality of the elements that have an impact on shareholders' equity. By refusing to exclude unusual items from the income statement, it attempts to leave no room for the subjective judgments that could lead, say, to charging losses to the balance sheet and gains to the profit or loss account. The IASB and the FASB have adopted this concept. The FASB (paragraph 39 of SFAC no. 5) defines comprehensive income as "a measure of the effects of transactions and events on an entity, including all recognised changes in net assets of the entity, except the investments by owners and distributions to owners." "Comprehensive income" is the sum of "net income" (the revenues less expenses of a conventional income statement) and "other comprehensive income" (the transactions and events formerly charged to equity).

Conclusion

At a time when IFRS is becoming the global benchmark for accounting systems, the current crisis is serving as a testing grounds for the suitability of both the conceptual framework of the IASB and the choices made in terms of accounting treatment. Currently, many critics are arguing that fair value is partly to blame for the spread of the crisis, especially as a result of its pro-cyclicality.

We have shown that this debate is biased because it is off target. Indeed, when the problem is analysed farther upstream and role of the accountant is clarified, it becomes clear that the amendments to IFRS 7 and IAS 39 are counterproductive. By making it possible, on certain conditions, to report at historical cost transactions that had previously been reported at fair value, these amendments reduce the amount of information contained in financial reporting. In addition, they allow more smoothing and more discretionary management of the accounts. These changes are likely to hide the real risks to which companies are exposed and to increase the mistrust of the financial community.

All the same, it is not because the measure of fair value and the choice of accounting treatments made by the IASB are highly debatable that it is therefore necessary to reject fair value accounting. We agree that the standards having to do with fair value need to be improved. Nonetheless, we believe that fair value fulfils its role as a source of information better than any alternative. The objective of accounting is to provide as reliable a description as possible of the net assets of a company at a given time, in the environment prevailing at the moment of the statement of the accounts. It has facilitated a swift reading of the depth of the crisis, a reading that would very likely have been made much

more difficult by accounting at historical cost. Fair value thus makes it possible to calibrate more appropriate responses to the crisis.

It cannot take the place of financial and prudential analysis. Accounting is but one of the means of evaluating the solvency of a financial institution. So it is not the function of accounting to determine whether a weakening of accounting capital should result in a demand for supplementary capital and/or in a reduction of business. It is the regulator who must make these determinations. The opportunistic gaming of prudential rules by banks (putting CDOs in the trading book in spite of their nature) should not serve as a pretext for doing away with fair value accounting. Confusion as to the source of the problem is created when the issue of gaming prudential rules is transformed into that of fair value in accounting standards.

This crisis also highlights and strengthens the relevance of the themes of our research programme on the impact of IFRS on company valuation, and it is encouraging us to continue examining several questions: What valuation methods should be used to value each representative item of the financial statements and what information should be included in the appendices? What is the impact of the choice of accounting treatments on corporate strategy? And on valuations? What presentation should be used for the income statement (comprehensive income?) and what intersection with the balance sheet should be chosen to be useful and relevant to those for whom the accounts are intended? Is there a compatible risk premium?

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