
Fair Value Accounting: Current Trends, Research and Teaching Implications

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Outline for Talk

- Background on the Fair Value Evolution
 - What's Happening? Why? The broader context.
- Implications for Academics - Research
 - Issues
 - Financial Reporting & Auditing
 - Methodologies
- Implications for Academics - Teaching
 - Student learning in an HC / Allocation paradigm.
 - Strategies for FV / Re-measurement paradigm.
- Summary

Background – Fair Value Evolution

- Recent Standards (*FAS 157/159*)
 - Addresses diversity in practice, introduces some of their own.
- *FAS 157/159* is not the beginning of the trend.
 - Prior Fair Value Standards, beginning with *FAS 115*.
 - Expanded Conceptual Framework (*CON7*)
- Broader Context – Movement to Principles-Based Standards
 - Requires focus on Assets/Liabilities – from matching to re-measurement... based on fair values.
 - Financial Presentation Project (put in a plug).

Background – Fair Value Evolution

- Financial Statement Presentation Project
 - Joint with the IASB... inception ~ 2001.
 - Partly informed / influenced by a 2005 CFA Report.
- Key Elements
 - Major reformatting of statements to gain consistency *across* statements, but allow companies to choose classifications according to how they manage the business (management approach, a la *FAS No. 131.*)
 - Operating / Financing is the main cut – consistent across IS, BS, SCF
 - Considering new structures to accommodate transparent reporting of fair value re-measurements (one example from CFA report).

Figure 3. Trans-Global Exports, Ltd., Statement of Changes in Net Assets Available to Common Shareowners, Year Ending 31 December 20X4

	Current- Period Accrual Transactions	Estimates	Change in Fair Value of Related Assets & Liabilities	Net Change in Net Assets
Operating				
Sales	€2,775,000			
Bad debt expense		€ (50,500)*		€2,724,500
Cost of goods sold:				
Purchases of inventory	(1,275,000)			
Direct labor	(110,000)			
Allocated overhead		(105,944)		
Ending inventory— beginning inventory		(446,250)		
Total cost of goods sold				(1,937,194)
Other compensation expense	(107,500)			(107,500)
Rent expense	(120,000)			(120,000)
Pension expense	(1,200)	(2,400)		(3,600)
Depreciation expense		(75,000)		(75,000)
Other operating expense	(150,000)			(150,000)
Income tax—operating activities	(99,362)	(33,121)		(132,482)
Net operating activities	€ 911,938	€(713,215)	0	€ 198,724
Investing				
Revaluation of building to fair value			160,000	160,000
Dividend income—marketable securities	9,250			9,250
Marketable securities: revaluation to fair value			11,100	11,100
Equity in earnings of affiliate	12,250			12,250
Income tax—investing activities	(77,040)			(77,040)
Net investing activities	€ (55,540)	0	€171,100	€ 115,560
Financing				
Interest expense	(252,378)			(252,378)
Income tax—financing activities	100,951			100,951
Net financing activities	€ (151,427)	0	0	€ (151,427)
Net change in net assets before transactions with owners	€ 704,971	€(713,215)	€171,100	€ 62,857
Dividends declared	(70,000)			(70,000)
Net change in net assets	€ 634,971	€(713,215)	€171,100	€ 92,857

*Parentheses indicate negative numbers

Background -- Summary

- We are well along a path to fairly broad adoption of fair value as a measurement objective.
 - FASB / IASB have been busy.
- Need to consider more than just the fair value standards to gain insights into their broader implications and the workability of fair value measurement.
 - Conceptual Framework
 - Financial Statement Presentation
- Get informed – Get Involved
 - Much work to be done ... Preliminary Views, Invitations to Comment documents will be issued
 - Please provide input to the FASB/IASB.

Implications for Academics - Research

Standard-setters need input from academics on fair measurement...

Research needed on:

- Efficacy of decisions made and on whether to expand fair value measurement.
 - Usefulness of the fair value hierarchy.
 - Relative relevance-reliability attributes of fair value measurements at different levels.
 - Are disclosures at different levels suitable?
 - Consequences of increased management judgment – not necessarily bad? Does it lead to manipulation or communication?
 - Consequences of increase volatility?

Implications for Academics - Research

- Audit Issues
 - Auditing an process, rather than the number.
 - Assessing controls over fair value measurements (e.g. Blackstone).
- This research agenda requires / can be addressed with multiple methodologies – archival / behavioral / analytic.

Implications for Academics - Teaching

- Some assertions about how accounting measurement has been taught ... teaching metaphors of the past:
 - Orientation has been in an HC / Allocation paradigm (this is also how most faculty learned.)
 - Primacy of reliability (verifiable & neutral attributes).
 - Primacy of the income statement → matching.

The movement to fair value requires new metaphors.

Implications for Academics - Teaching

- Fair Value teaching metaphors... can not wait.
(as I noted earlier – the fair value “horse is out of the barn” ...fair value measurement is pervasive and increasingly so: Asset exchanges, AROs, Impairments, Stock Options, other derivatives.)
 - Consider motivating usefulness of financial reports in terms of assets and liabilities and how a focus on assets and liabilities (and measurement of their changes) can provide relevant and reliable information (see FASB Rev. Recogn. Case)
 - Abandon / downplay rationales for accounting measurement based on matching, conservatism, and giving inordinate weight to subjectivity concerns.
- (Note, in many cases, HC is **not** representationally faithful and **is** subject to just as much estimation/judgment as FV.)

Implications for Academics - Teaching

- Strategies -- Not likely addressed by a chapter on fair value at the beginning of accounting textbooks.)
 - Teach the Conceptual Framework and put measurement attribute issues in proper context vis-à-vis relevance and reliability.
 - “Infuse” fair value measurement concepts throughout the accounting and business curriculum.
 - Accounting -- Introductory / Intermediate / Advanced
 - Coordinate coverage with finance and statistics.
- Techniques
 - Case studies – use to illustrate implementation challenges and implications of the use of fair values... put in real business contexts.
 - Rather than giving students the fair values, let them develop them using expected cash flow or comparable techniques.

With *CON 7*, *FAS 157*, *FAS 159*, the FASB has given us a great instructional framework for learning about measurement attributes.

Summary

- ❑ Fair Value “horse is out of the barn”
- ❑ Broader implications than just the fair value standards – principle-based frameworks new reporting packages... see CFA report:

<http://www.cfapubs.org/toc/ccb/2005/2005/4>

& FASB project:

http://www.fasb.org/project/financial_statement_presentation.shtml ... get a glimpse of what [new financial statements](#) could look like.

- ❑ A number of financial reporting and audit research opportunities.
- ❑ Now is the time to start/continue to change our teaching metaphors to prepare students for an accounting world of increasing fair value measurements.