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Critical Evaluation of the Fairness of the Fair Value Concept

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ABSTRACT

The research exercise is to appraise fairness in fair valuation methodology from the perspective in accounting and finance through analysing the application of fair value method of costing in International Financial Reporting Standards (IFRS) and assessing the usefulness of fair value in improving investor and observer decisions. The research reviews theories and modern trends in the field of fair value and emphasizes the challenges and limitations facing its application. The research highlights the need for clear and specific standards to determine fair value and calls for further research in this area to enhance transparency and fairness in financial markets. Although many studies have shown that the use of fair value is limited due to the need for reliable estimates at a low cost, the International Accounting Standards Board (IASB) and other accounting standards boards have encouraged the use of fair value to improve the comparability and updating of financial information. One of the main findings is that fair value is still not widely used in the valuation of illiquid non-financial assets, in addition to the fact that IFRS standards encourage the use of fair value in the valuation of assets and liabilities.

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1. INTRODUCTION

Arising from the need to harmonise the methodology in fair value measurement and disclosures as stipulated in the various IFRS standards in use and those formulated by the US Financial Accounting Standard Board (FASB), the International Accounting Standards Board (IASB) resolved for the development of this standard – IFRS 13. Prodanova et al (2019) encapsulated "a comparative analysis of fair valuation techniques as enshrined in IFRS and US GAAP standards for purpose of ascertaining the most appropriate valuation method that will provide accurate estimates considering prices prevailing in the observed markets. The study recommended a new audit algorithm for the validity of the valuation of assets and liabilities at fair value based on obtaining audit evidence to determine whether the estimates in the financial statements are reasonable in relation to the applicable financial reporting framework or are distorted by operators".

Abiahu et al (2020) study which evaluated "the effect of fair value reporting on financial profitability and firm value with focus on deposit money banks listed on the Nigerian Exchange Group supported the postulation of fair value reporting not significantly affecting reported profitability rather fair valuation methodology impacts on firm valuation and therefore knowledge of fair value is not sufficient criteria in evaluating financial performance and position of entities. The study opined that users of financial reports also need knowledge of the historical cost of the investment in the entities and therefore adoption of a hybrid measurement technique that will incorporate both fair and historical valuation reports so as to highlight actual value creation". Nigro & Stahl (2021) study focused on "unavoidable value-destroying trade sales and standard corporate contract and opined that social welfare through venture capital should feature flexible fair value protections". Agyemang et al, (2019) study which was to identify "fair valuation technique adoption challenges that small and medium scale enterprises (SMEs) encounter highlighted fair valuation method as the most preferred method of valuing biological assets. The study further reported absence of commodity market in Ghana as from the study the commodity sales reported in the study then in Ghana was through market intermediaries or the middle traders who might not have been providing genuine information to the farmers. Also the study showed fair value measurement technique is essential since commodities prices unpredictability makes it current value suitable to provide market information as a basis for making estimate for the fair valuation of biological assets as their current pricing provides vital information to enable users to take rational decisions. The study also commented on lack of synchronisation of training development between the academic and professional programmes as there is dearth or inadequacy in manpower training and education for preparers of financial statements and academic education did not focus on agricultural accounting, complexity in IFRS 13 and the difficulty in enforcement at the SMEs level".

According to Christensen and Nikolaev (2012), "selection between fair valuation method or historical cost accounting method is one of the most widely contested issues in accounting reporting. One constraint in advancing the argument is the lack of adequate proof on the best choice between the two accounting practices – historical cost accounting and fair valuation measurement and whether the choice is determined by market forces rather than regulators" On Kothari et al. (2010), fair value measurement is premised on the presumption of being most needed in aiding decision making by users of financial statements. According to Aboody et al. (1999), revisions to fair valuation technique allows executives to transfer their private information on asset values. Fair valuation technique is also stated to improve transparency, comparability, and the timeliness of accounting information (Schipper 2005).

1.1 Justification for Fair Value Standard Adoption

"Prior to its development, some accounting standards developed by IASB required or permitted organisations to measure or disclose the fair value of its assets, liabilities or their own equity instruments. As these accounting standards were developed over many years past, the requirements for measuring fair value and for disclosing information about fair value measurements were scanty and in many instances the standards did not articulate a clear measurement methodology or disclosure objective. Of serious concern within the accounting profession is the growing complexity,

extension and importance of issues connected with fair value measurements in today's financial reporting of entities' operations" (Schipper 2005). According to Suren et al (2019) "banks' reported fair valued assets and liabilities are positively associated with bank reported small earnings increase. The study also found the level 2 fair valued assets and liabilities are a prime determinate for the relationship between banks reported fair valued assets and liabilities association with the banks reported small earnings increase". Also according to Di Martino et al (2022), "banks that operate an environmental, social and governance (ESG) indicator scoring points are valued at a premium on the book value of the banks and an ESG score is linked with value-relevance of the fair value items and that the banks ESG scores decreases according to value relevance of level 2 and 3". Sampaio et al, (2022;) study on "how financial crisis shaped fair value accounting literature, reported an improved awareness in fair value accounting literature which is attributed to the 2008-2009 financial crisis and a further deviation on fair value accounting policies such as fair value measurement, earnings management and value relevance".

Studies have found scanty adoption of fair value accounting costing on non-financial assets like human capital asset as it is only applied when reliable fair value estimates are available at a low cost and when they convey information about operating performance.

Arising from the above, some IFRS standards contained limited guidance on fair value measurement whereas other standards contained extensive guidance but the various guidance are not consistent across the respective IFRS fair valuation standards. There is therefore inconsistencies in the requirements for measuring fair value and for disclosing information about fair value measurement thereby contributing to diversity in practice among organisations and had therefore reduced the comparability of information reported in financial statements.

In a bid to address the perceived anomaly, IASB through a rigorous session and collaboration with US FASB developed a project agenda with the following objectives which midwifed this IFRS 13:

i. To establish a single set of requirements for all fair value measurements' required or permitted by IFRSs to reduce complexity and improve consistency in their application thereby enhancing the comparability of information reported in financial statements
ii. To clarify the definition of fair value and related guidance to communicate the measurement objective more clearly
iii. To enhance potential disclosures about fair value measurements that will help users of financial statements assess the valuation techniques and inputs used to develop fair value measurement.
iv. To increase the convergence of IFRSs and US Generally Accepted Accounting Practice (GAAP).

The emergence of IFRS 13 thus provided single source of fair value measurement guidance that clarifies the definition of fair value as applied in other released standards. The standard also provided the framework for measuring fair value and enhanced the disclosures about fair value measurements as well as uniformity with US GAAP except for minor differences in wordings and style.

2. CONCEPTUAL REVIEW

2.1 Concept of Fair Value Reporting

Fair value accounting also referred to as market-to-market accounting has been at the centre of disparagement across the globe. Some critics postulate that fair value accounting has led to unnecessary downward spiral of asset valuation. The result of Banerjee & Paul, (2024) study on effect of fair value measurement on the financial performance of selected NSE-listed companies showed no company under the 2 sectors studied performed very poorly after their disclosures under fair value measurement instead the studies showed the companies tried to improve their financial reporting by implementing proper disclosures and nomenclatures. Sebastian et al, (2014) study on "relevance and credibility of the fair value measurement during the crisis' centred on the choice of valuation technique for measuring assets and liabilities for relevance and credibility. The authors opined that the controversies that surround the study hinges on the selection of evaluation techniques applying historical costs method or fair value method as each of them have its advantages and disadvantages which is addressed through the objectivity of the evaluation process and of 'opportunity and credibility' of the accounting information reported in the financial statement of

the organization as well as the concern of the entities involved in the international accounting normalization. Also problems arose when the estimation of the valuation technique to apply in market periods of growth or decline or in the absence of an active market and situations involving professional judgement and the possibility of valuation manipulation. Notwithstanding, the introduction of fair value measurement in some accounting standards has increased over the years geared towards driving transparency and quality financial reporting. It is pertinent to know therefore what fair valuation represents as a basis of entities valuation measurement".

International Financial Reporting Standard (IFRS) previous edition defined fair value as "the amount for which an asset could be exchanged, a liability settled or an equity instrument granted could be exchanged between knowledgeable and willing parties in an arm's length transactions".

Wikipedia defined fair value as a rational and unbiased estimate of the potential market price of a good, service or asset. The source of valuation takes into account such objective factors such as the costs associated with production or replacement, market conditions and matters of supply and demand. Jarolim and Oppinger (2012) defined fair value as "the amount which could be transferred in a fictitious transaction between knowledgeable and willing parties under normal market conditions (arm's length transaction)". According to Investopedia, "it is a measure of a product or asset's current market value and a reflection of that price at which an asset is bought or sold when a buyer and a seller freely agree to sell".

The standard itself - (IFRS 13) defined fair value as that price that would be received to sell an asset or paid to transfer a liability in an organized transaction between market participants (buyer and seller) at the measurement date. In other words, fair value is that price that an asset or obligation would fetch in an organized market transaction at the measurement date (Wisdom et al, 2022). This definition has highlighted the following special characteristics/assumptions for fair value costing worth noting:

a) Fair valuation assumes an organized contract between market participants therefore a current market price (market-based) measurement and not an entity-specific measurement. The market determines the value and not the interested party entity.
b) Fair value costing measurement presupposes that the transaction to trade the asset or transfer the liability takes place in the most advantageous market to which the entity has access. It is current market price (market-based) measurement and not an entity-specific measurement and hence fair value reflects current market conditions (which reflect market participants not the entity's current expectations about future market conditions)
c) Fair value measurement as is defined under IFRS 13 is a current exit price. Respondents have opined that the definition of fair value as a current, market-based exit price is appropriate as it retains the notion of exchange between unknown or unrelated personalities as buyers and sellers, knowledgeable and willing parties in the definitions of fair value in stated in the IFRS respective standards although it provides a clearer measurement objective.
d) Fair value is not closing or liquidation price or value which is considered an immediate sale value in which the seller is compelled due to unavoidable circumstance to enter into the given transaction.

2.1.1 Fundamental principles of Fair Value reporting

The following fundamental principles are thus expected of fair value pricing

i. Organized business procedure or transaction which assumes full knowledge or acquaintance to the market for a period prior up to the measurement date to allow for marketing activities that are normal and routine but not a pressured or forced sales or distress sale. Also in the absence of an actual transaction, an imaginary transaction from the standpoint of a market participant that holds the asset or owes the liability.
ii. Most valuable or primary (or principal) market. Assumption of the business deal taken place in the most valuable market for the firm. The ideal valuable market is defined as that transactional arena or situation that ensures the best amount that would be received to sell the asset or reduce the amount that would be paid to transfer the liability in service.

iii. Market (customers) participant: The standard states that fair value determination is a current prevailing rate (market-based) pricing, not a price fixed solely by the entity (an entity-specific) pricing. Fair value determination thus uses the assumptions that open buyers and seller (market participants) would use when bidding or pricing the asset or liability. All buyers and sellers (market participants) are presumed to be independent of the reporting entity and they fully aware i.e. have a reasonable understanding about the assets or liabilities values and the business transaction is based on all available information. Similarly, the buyers or applicants are motivated and willing to trade or transact for the assets or liabilities and not overtly pressured, coerced or forced to do so.
iv. The price: The standard stipulates that the unit amount used in pricing to measure fair value should not be net of transaction or transport cost of the asset or liability sale. The transaction or transportation costs are considered as not characteristics of an asset or a liability but characteristics of the transaction.

2.1.2 Essence of fair value reporting

In the new globalized economies and reporting and international accounting standard formulation for uniformity in reporting, there is much focus on fair valuation of assets and liabilities in financial reporting and decision making. This is because IFRS emphasizes much on the statement of financial position valuation approach which makes the valuation more relevant and transparent as beneficiaries (shareholders and various other stake holders) will have the knowledge or information of the fair value of entities' assets and liabilities similar to that of the entities' management. For managerial or investment decision making, fair value reporting is much relevant as the present and future estimates are essential in taking cautious decision. Fair value measurement is germane, realistic estimation of the entity's assets and liabilities. It produces prognostic valuation, is timely and comparable. Fair value measurement also highlights the present economic conditions of the assets and liabilities so presented in the financial statements. Similarly, they are relevant and neutral because they have analytical value as they help forecast future cash flows and they are unbiased and comparable because they depend on the characteristics of the asset or the liability being measured.

2.1.3 Fair value and market value or current value

Fair value rate which is the anticipated current market value of a product or asset is a reflection of the price at which an asset is bought or sold when a buyer and a seller freely agree to sell. This is different from market value. Whereas fair value rate is the price that is reasonable between the two specific parties (buyer and seller) in the transaction taking into account their respective advantages or disadvantages that each will gain from the transaction, market value rate may not be reasonable to meet this criteria as their respective advantages or disadvantages may not necessarily always be the same. Essentially, fair value measurement method is often applied when undertaking due diligence in corporate transactions, where particular interactions between the two parties may mean that the price that is fair between them is higher than the price that might be obtainable in the wider market.

Generally, fair value measurement is the present market value of the item. However, present market value do not represent fair value measurement as in some accounting reports, some particular of specific company present valuation methods are applied to measure the company's assets.

2.1.4 Fair value as a current exit price

The IFRS 13 defined fair value as the current exit price. The Internal Accounting Standard Board (IASB) opined that exit price of an asset or a liability embodies expectations about the future cash flows and outflows that are associated with the asset or liability from the perspective of the seller (the market participant) that owns the asset or owes the liability at the measurement date.

2.2 The Asset or Liability

The IFRS 13 states the asset or liability value measurement takes into account the condition or feature of the asset or liability like appearance and location of the asset and possible restriction if any on its sale. Also the use of the asset affects its fair value if market participants would take the restrictions into account when pricing the asset at the measurement date. This is in line with IAS 40, IAS 41.

2.3 Market Participant

"IFRS 13 stipulate fair valuation as a market-based valuation and not an entity-specific valuation. Therefore, fair value rate uses the assumption that traders and buyers (market participants) would use when pricing the assets or liability. Market participants are defined as buyers and sellers in the main (or most strategic) market for the asset or liability who are independent or sovereign in thought and decision making of each other (i.e. they are not related parties), abreast about the asset or liability and able and willing to enter into a business relationship for the asset or liability. Although the previous definition of fair value in other IFRS standards referred to market participants as "knowledgeable and willing parties in arm's length transaction", the IASB stated that the previous definition expressed the same notion as the IFRS 13 on fair value definition but that the previous definition was less clear" (Schipper 2005).

2.4 Application of Non-Financial Assets

"IFRS 13 standard do not require an entity to perform an exhaustive search for other potential uses of a non-financial asset if there is no evidence to suggest that the current use of the asset is not its highest and best use. The standard stated that fair value rate takes into account the highest and best use of the asset from the perspective of traders and buyers (market participants). Likewise if a firm acquires an asset with the intention to block or prevent its competitive position or for other reasons and does not intend to use the asset actively or does not intend to use it in the same way as other market participants do not require exhaustive search for other potential uses" (Schipper 2005).

2.4.1 Valuation method of non-financial assets

The standard highlighted the following two valuation methods after the exposure draft initially proposed by IASB; "the in-use valuation premise and in-exchange valuation method" were reviewed.

2.4.1.1 In-Use valuation premise otherwise called in-combination with other assets and liabilities basis

Here the Board assumes the individual assets values are measured in the perspective of its application with other assets as a group and that the buyer- market participant has the complementary asset – the right to manage or operate it. This is applicable in condition where the highest and best utilization of an asset is to deploy it with other assets or with other assets and liabilities as a group. This valuation adoption assumes that the exit price would be the price for sale to a market participant that has or can obtain the other assets and liabilities needed to generate cash inflow by using the complementary assets and the associated liabilities.

2.4.1.2 In-exchange valuation basis or stand-alone basis

Here the fair value of the asset is considered as the price that would be received in a current transaction (open market) to sell the asset to market participants who would use the asset on a stand-alone basis. This implies when the highest and best use of the asset is to use it on stand-alone basis. This valuation adoption is on the assumption that the disposal of the asset would be to market participant that will deploy the asset alone and not with other assets (a stand-alone basis).

2.4.2 A single non-financial asset

IFRS 13 standard states single non-financial asset as assets being measured at fair value and being sold on its own. The asset therefore should be measured accordingly even if transactions in the asset are typically the result of sales of the assets as part of a group of assets or a business.

2.5 Application to Liabilities

"On the application to liability valuation, IFRS 13 standard stipulates an entity may measure the fair value of its liability by using a quoted price of an identical or similar liability held by another party as an asset or by using another valuation technique like an income approach technique. IASB further stipulated that when there is no observable market price for the transfer of a liability and the identical liability is held by another party as an asset, an entity can measure the fair value of the liability from the perspective of a market participant that holds the identical liability as an asset at the measurement date. This measurement technique is consistent with US GAAP. In summary fair value of a defined liability equals the fair value of a properly defined corresponding asset assuming defined sales

transactions is feasible from both positions in the same market. A defined corresponding asset is an asset that transactional or fair value or features mirror are like those of the liability" (Schipper 2005).

2.5.1 Non-performing risk

In valuing non-performing risk, IFRS 13 stipulates a fair value determination fair value of a liability should reflect the effect of non-performance risk. Non-performance risk is defined as the risk that an entity will not fulfil its defined obligation. This risk include but not limited to an entity's own credit risk (credit standing).

2.6 The Fair Value Hierarchy

"Fair value hierarchy concept of valuation emphasizes the application by firms of market inputs in estimating the fair value for an asset or liability adopting either value in exchange approach or value in use approach. It is generally postulated that quoted prices are the most accurate valuation method for fair value determination. However, there are instances that an active market may not exist and so other methods have to be applied in determining the fair value on an asset or liability. Here, the techniques to apply in estimating fair value should be from the perspective of an unrelated market participant. This necessitates therefore identification of the market in which the asset or liability presently trades. The most advantageous market should be applied in valuation. In determining which market is the most advantageous market, the price and transaction costs must be considered. Fair value hierarchy concept comprises three levels to establish the level of judgment that may be involved in estimating fair valuation" (Schipper 2005).

2.6.1 Level 1

"Fair valuation is classified as Level 1 in the fair value hierarchy, if observable inputs for valuation are premised upon quoted market prices of identical assets and liabilities in active markets. In order words fair value is determined as the unadjusted quoted price in the active market ie market value. Quoted price in an active market should be an actual and regularly occurring market transaction and the prices of those transactions should be regularly and readily available" (Schipper 2005).

In addition, the fair value should be the unadjusted quoted price (not a rate based on quoted rate or index) observed in the active market. In case the quoted price is adjusted to arrive at a fair value, then it is not a Level 1 measurement.

2.6.2 Level 2

Level 2 inputs are those inputs other than quoted market prices that are included within Level 1 that are observable for the asset or liability, either directly or indirectly. Valuations here are generally gotten from third party pricing services for similar or identical or comparable assets or liabilities or through the use of valuation methodologies using observable market inputs. The inputs here are derived principally from or corroborated by observable market data by correlation or other means.

2.6.3 Level 3

"The use of level 3 valuation method is sometimes referred to as "mark-to-model" accounting and it is used when observable inputs are not available (FASB 2006). In this condition, unobservable inputs are used to measure value to the extent that relevant observable inputs are not available. Here fair value is estimated using valuation methods that are based on present value techniques of future earnings, or cash flows and these valuation techniques taking into account the significant unobservable inputs. It is necessary to note fair value based on the judgment of future cash flows is entity-specific. Entity-specific means that the same asset can be measured differently for two companies because of their different lending rates and two entities managerial appraisals. Therefore, the consistency of fair value estimates declines with the shift from liquid markets to non-traded items. In other words, fair value is the facility to recognize unrealized gains in the profit & loss account which can happen in financial instruments held for trading. Level 3 assets are financial assets and liabilities that are considered to be the most illiquid and hardest to value. The assets and liabilities are not traded frequently hence difficult to place reliable and accurate market price" (Schipper 2005).

3. FAIR VALUE APPLICATION ON OTHER INTERNATIONAL ACCOUNTING STANDARDS

3.1 Under IFRS 2

Share-based Payment: The measurement objective for share-based payment transactions.

The standard stipulates the adoption of fair value at the grant date for all equity settled share-based payments, as well as the use of fair value for cash settled transactions, with value changes being recognised in financial statement.

3.2 Under IFRS 3

Business Combinations: The measurement of reacquired rights as an exception to fair value. The standard establishes the following principles in relation to the combination: Recognition principle, identifiable assets acquired, liabilities assumed and non-controlling interests in the acquiree. are recognized separately from goodwill. The standard here requires all of the identifiable assets and liabilities of the acquiree to be included in the consolidated statement of financial position.

3.3 IFRS 7

Financial Instruments: The standard here stipulate financial assets and or liabilities as well as non-derivative financial liabilities to be measured at fair value through profit or loss and if the assets and or liabilities are held for trading or classed as 'available for sale' then subsequent measurements are also at fair value.

3.4 IAS 16

Plant, Property and Equipment (PPE): Here the standard stipulates all items of property, plant and equipment gotten in exchange for non-monetary assets or a combination of monetary and non-monetary assets should be measured at fair value, except when the exchange transaction lacks commercial substance or the fair value of neither of the assets exchanged can be determined reliably. In that circumstance the cost of the asset acquired in the exchange should be measured at the carrying amount of the asset given up.

3.5 IAS 19

Employee Benefits: Here the standard stipulates the entity to disaggregate the fair value of the planned assets into classes that distinguish the risk and liquidity characteristics of those assets held in the statement of financial position. The standard also stipulates separation of each class of debt and equity instruments into those that have a quoted market price in an active market and those that do not.

3.6 IAS 36

Impairment of Assets: The standard is about valuation of assets for which recoverable amount is fair value less costs of disposal. Recoverable amount is measured whenever the asset may be impaired, and the need to impair must be assessed at each reporting date. Recoverable amount is defined as the higher of fair value less selling costs or value in use.

3.7 IAS 38

Intangible Assets: The standard stipulates the carrying value for an intangible asset in the Statement of Financial Position to be stated as either cost less depreciation or fair value (where there is an active market).

3.8 IAS 40

Investment Property: The standard stipulates entities to choose between fair value model and cost model. Entities are expected to apply the chosen model to all its investment property. The fair value model for investment property should measure the property at fair value and changes in fair value should be recognised in the income statement.

3.9 IAS 41

Agriculture: Biological assets: This standard contains a reliability exception for biological asset on initial recognition by measuring biological asset at cost less any accumulated depreciation and any accumulated impairment losses. Also if the reliability exception is applied but fair value subsequently becomes reliably measurable and therefore an entity started measuring the biological assets at fair value less estimated point-of-sale costs, the entity should disclose a description of the biological assets, an explanation of why fair value has become reliably measurable and the effect of the change.

4. MODELS AND RELEVANCE OF FAIR VALUE ACCOUNTING

4.1 Models of Fair Value Accounting

Fair Value accounting method can be grouped into four conceptual models with respect to the integration of realized and unrealized holding gains and losses. The key features of the models are equity approach, mixed approach, income approach, and full fair value approach as outlined below:

List 1. Fair Value accounting method grouped into four conceptual models

Model	Unrealized Gains	Realized Gains
Equity approach	Record in revaluation reserve (Equity). `	Credit revaluation reserve (Equity). Realized gains does not affect period operational performance and so do not affect the income statement. Example IAS 16
Mixed approach	Record in revaluation reserve (Equity). Example IAS 39	Record realized fair value changes in income statement. Example IAS 39
Income approach	Record all the property gains and losses resulting from changes in fair value in income statement	Record all the property gains and losses resulting from changes in fair value in income statement
Full fair value	Record all fair value changes plus internally generated goodwill in the income statement Income	Record all fair value changes plus internally generated goodwill in the income statement Income.

Source: Author formulated (2024)

Internally generated goodwill is the difference between the equity value of the entity (or discounted future cash flows of the entity) and the book value of its equity, where fair values are used to measure separable assets and liabilities. Internal goodwill refers to the organizational efficiency of the firm which is distinct from purchased goodwill, which is recognized on the balance sheet as an intangible asset. The measurement and capitalization of self-produced goodwill is not recognized because of a lack of reliability.

4.2 Relevance and Usefulness of Fair Value Accounting

In other to evaluate the merits or otherwise of applying fair valuation method as against historic cost method on a statement of financial position it is worth understanding the purpose of financial statements in business reporting of entities.

The International Accounting Standard Board (IASB) conceptual framework stated that financial statements should fulfil the purpose of evaluation of performance (stewardship rendering) and a channel of appraisal of information for economic decision-making like investment decision. The relevance and usefulness of fair value method of valuation of assets and liabilities at financial year end therefore needs to be assessed within this context.

4.2.1 Relevance versus reliability

The deliberation about applying fair valuation method as against historic cost method has revolved around the divergence between relevance and reliability. According to Amaefule et al. (2018) fair value measurement as encapsulated in the international financial reporting standards (IFRS) 13 does not automatically translate to improved performance of Nigeria firms. Wisdom et al (2022) in their studies on fair value accounting and investment decisions in Nigerian listed companies posited that fair value accounting as having a negative but significant relationship with shareholders investing decision. KPMG (2020) in it study ‘measuring fair value in unsettled times posited that measuring fair value can present significant challenges for preparers of financial statements even in the best of times because it may involve judgment and estimation. Al Sawalqa (2016) posited that prior studies in fair value accounting have unanimously agreed on the existence of clear defects in measuring fair value, especially under level 3 of fair value hierarchy where the active market does not easily exist for the asset or liability. The study reported the relevance of fair value for decision-making process colliding with the availability of active markets in practice is an ‘exceptional phenomenon’ and the problem therefore encourages organization to use level 2 and level 3 of fair value hierarchy in which instance the subjective valuation method distorts the actual market price of asset or liability at the date of measurement. The authors opined this problem is expected to mislead the decision-makers. Al Sawalqa (2016) study also revealed the disclosed accounting information that resulted from their using level 2 and level 3 of fair value hierarchy was based on subjective estimation of entities’ managements thus an indicator that such information is unreliable and not relevant enough for decision- making process.

Also Kaur (2013) posited that historical cost valuation that is premised on judiciousness or conservatism produces steadiness since necessary provisions are provided and the unpredictability in income and profits is thus minimised to a reasonable position. There is thus a sense of dependability among stakeholders (users) towards the figures in the financial statements as they are considered reasonably free from overstatement and bias in valuation.

In the contrary, since fair valuation method make available data about up-to-date market state of affairs, it is believed to contain a credible basis for expectation order than the out-dated historical cost figures as being reported in the financial records of the entity.

4.2.2 The challenges adopting fair valuation to illiquid non-financial assets

Among non-financial assets are human capital assets. There is no defined standard accounting practice for measuring the value of human capital asset. Organisations individually adopt their own methods hence there is lack of comparability. Also human capital accounting valuation is also based on assumption taking into consideration the influences of trade unionism and labour turnover. As there is a wide difference among entities personnel on their intellect, abilities and motivations, some may be liabilities while some are human assets and since any transaction which cannot be measured in monetary value is not recorded according to money measurement concept, human capital is not treated as assets of entities and do not therefore appear in the statement of financial position (balance sheet) of the entities. In fair valuation of non-financial assets, market participants' ability to generate economic benefits is considered. The paucity of information therefore for valuation of illiquid non-financial assets like the human capital assets is very critical in ensuring transparent reporting. Presently, the current practice whereby entities' management are given yearly performance targets, there is potential manipulation of financial statements via creative accounting practices to enhancing their performance. The lack therefore of internationally defined structured methodology in measuring illiquid non-financial assets like human capital assets therefore cast curiosity, credibility and acceptance in fair valuation measurement of non-financial assets like human capital in entities financial reporting in the current business world.

5. CONCLUSION

The contention as to adopting fair valuation method as against historic cost method has raised pertinent, crucial and fundamental inquiries on core accounting concerns, such as the manner performance need to be evaluated or appraised, and the potential or probable advantages of the qualities of relevance and reliability. The study has noted the lack of defined standard accounting practice to measure human capital assets and so entities individually adopt their own methods hence there is a lack of comparability. Also revealed is human capital assets valuation which is based on assumption which taken into consideration the influence of trade unionism and labour turnover and not through pure and defined merit valuation method. The fair value methodology is considered as a diversion or change in entities method of financial reportage from the historic focus to current perspective of entity's valuation. However, there is no provision in the standard to measure non-financial assets like human capital assets and in particular internally generated goodwill of entities even though some entities might have substantial and material non-financial assets that impact significantly in its operations. There is the need for International Accounting Standards Board (IASB) to carry out the review of the current standards on fair value practices as stated in the present standards so as to enhance firms' operational reportage across national borders. This article is a theoretical review article critically evaluating the fairness of Fair Value Concept as it is presented in IFRS 13 and other standards embedded with fair valuation clauses.

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Author(s) hereby declare that NO generative AI technologies such as Large Language Models (ChatGPT, COPILOT, etc.) and text-to-image generators have been used during the writing or editing of this manuscript.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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