

Fair Value Accounting and Management Behaviour

A Literature Review

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Abstract

IASB have chosen fair value accounting to reach the goal of create a financial reporting able to help investors (more in general users) in decision-making process. During recent years, an intense debate has arisen relative to trade-off between relevance and reliability that has been originated in connection to fair value accounting. Usually fair value information are relevant and helpful for investors but many authors have outlined that some problems could arise because of unobservable inputs. Considering problems related with FVA, main objective of this paper, is to furnish a review of the academic literature on the management behaviour related to FVA and effects of unrealized fair value adjustments on firms' dividend policy. An unique conclusion on this theme is not yet reached, however by surveying the empirical results, it is evident that the fair value from market (Level 1) is significant different from fair value based on manager's valuation (Level 3), so standard setters have to make some more efforts to ensure a faithful representation of business events.

1. Introduction

Financial reporting help investors in decision-making process. To reach this scope, IASB chose fair value accounting (hereafter "FVA"). The FVA links carrying amount to current market price rather than to value of a past transaction, so it seems able to show potential cash flow generated from assets or liabilities included in financial statements (Tutino & Pompili, 2013).

During recent years, an intense debate has arisen relative to fair value and relative to trade-off between relevance and reliability that has been originated in connection to this accounting criterion. Many authors claim that usually fair value information are relevant and helpful for investors even if some problems could arise because of unobservable inputs. In such cases, fair value estimates depend on management choices and this can bring to errors and, consequently, in an increase of information asymmetry due to private information not shared with stakeholders ("adverse selection" and "moral hazard" problem). Furthermore, unobservable inputs could be used as earnings management tool carried out by management in order to pursue their own goals aligning biased estimates able to meet investors' expectations.

FVA could also lead to large transitory changes in net income depending on market value trend. In this way, firms use to report unrealized gains and losses, this behaviour leading to two different problems. First, if investors are not able to correctly assess these earning components, volatile fair value adjustments included into net income would introduce noise in decision-making process. Second, if management will distribute dividends based on unrealized earnings, firms' financial risk could increase and financial stability could be compromised.

Considering problems related with FVA, main objective of this paper, based on content analysis approach, is to have a look to the state of art in the academic literature on the management behaviour under FVA and effects of unrealized fair value adjustments on firms' dividend policy. Retrace and understand the intense debate on fair value is designed to create the basis for future research that can provide explanations and solutions to the issues still under discussion.

The rest of the paper is organized as follows. Section 2 provides a short theoretical background on FVA. Sections 3 and 4 focus on literature, respectively on relationship between FVA and earning management and on impacts of FVA on dividend policy. Conclusions are presented in section 5.

2. Background

For International Accounting Standards Board (IASB) primary users of financial reports are existing and potential investors and fair value represents the main criteria to allow them to take decisions on investment policy (i.e. resource allocation decisions)¹. FVA requires use of market values for preparing financial statements and in this way income statement shows also “potential” income due to unrealized gains and losses recognized in order to align value of assets and liabilities at their market value even though they are not subject to purchase or sale. This represents a deep change respect use of historical cost.

In accordance to it indeed, income statements show a distributable income equal to a realized one, with gains and losses recognized only in case of transactions with a third party. In this sense, fair value incorporating expected future cash flows from asset subject to evaluation, seems to have the advantage to capture share of income accruing for the year, so it could be useful for who, as investors, are interested in ability of company and of its assets to generate future cash flows.

Many criticisms have been made to historical cost due to its inability to provide an updated view of portfolio assets of the company, and therefore to reduced comparability of financial statements prepared in accordance with it. In those circumstances, fair value seems to be able to increase transparency and comparability of financial statements, in both time and space, and in this way it achieves one of main goal of international accounting standards (Tutino & Venuti, 2016). Therefore, international standard setters (IASB and FASB, primarily) have identified FVA as one of the major innovation for investors; moreover, it can push financial statements volatility as well as reveal hidden reserves and unrealized losses.

On the other hand many authors and practitioners have criticized a full FVA underlying that the application of the criterion may conduct to a less reliable reporting than historical cost criterion application, especially in case of *illiquid market hypothesis*, that meaning primarily (1) not directly observable inputs, and consequently (2) adoption of estimates which potentially suffer of errors because of discretionary parameters.

Different views on FVA are well summarized by Whittington (2008): a “*fair value view*” and an “*alternative view*”. According to the first, markets are complete and perfect and, thus, financial reporting is used to meet the needs of investors; in these circumstances, market prices should give a non-entity specific estimate of potential cash flow.

According to the second view, markets are incomplete and imperfect and financial reporting should be a useful tool to monitor and evaluate management stewardship, so it should be focused on past transactions effects and it should use entity specific measures.

Interesting is thus understand and analyze in detail which problems are arose from an intensive use of FVA and which solutions are been taken as well as their impacts on financial statements and more general on financial markets and economic environment. Should be underlined that criticisms are done not only on the conceptual validity of fair value but also on its practical application. In fact, no problems there are if markets are liquid and prices are easily observable but many difficulties arise if markets are not active, in these cases fair value should be calculated by estimations (mark-to-model) and these are affected by errors, by definition. In general, is possible affirm that observability of valuation inputs is the main factor affecting the reliability of fair value estimates.

Moreover, FVA, resulting in a substantial alignment of the book values with the values expressed in the capital market, has also often been accused of generating pro-cyclical effects (Halioui & Gharbi, 2012; Chouinard & Youngman, 2008), or to increase profits for the companies

in periods of growth and to depress even more the same in the crisis periods (Haldane, 2012; Ronen, 2012). In this sense, some authors have attempted to investigate the effects of the introduction of FVA in terms of financial stability, with the analysis carried out that are primarily employed in relation to the banking sector during the financial crisis. The analysis have not led to a unique conclusion: authors are still divided between FVA “accuse” stating that FVA worsened the effects of the financial crisis (Allen & Carletti, 2008) and FVA supporters stating that the criterion is not chargeable since the financial crisis had different factors (Laux & Leuz, 2010;).

One of the main topic is, therefore, the relationship between FVA and income stability: under FVA, income volatility tends to grow no longer depending on company business results, but it is related to financial market conditions. These factors, as well as the different reliability of the estimates depending on the inputs used, make that many authors have given interest to possible opportunistic management behaviour. Managers may be pushed to provide biased estimates of fair value in order to stabilize earnings and in order to achieve its objectives in a context regulated by compensation mechanisms. Other concerns have arisen about effect of distribution of the unrealized income obtained under FVA in terms of capital integrity and firm’s value. The next sections are built with the intent of examine in depth these topics and with the aim of summarize position taken in literature during recent years.

3. Fair Value Accounting and Earning Management

Aim of this section is to analyze the possibility that management can manipulate data provided in financial statements in order to achieve their objectives at the expense of shareholders’ interests, especially in case of illiquid markets so in case for assessing fair value are used unobservable input (firm-specific inputs). As stated, in case of intensive use of unobservable inputs, concerns arise for possible errors estimation and management manipulations (Benston, 2008), this leading to (1) a lower investors decision process relevance of value reported in the financial statements (Goh, Ng, & Young, 2009; Song, Thomas, & Yi, 2010) (2) a greater correlation with level of information asymmetries (Liao, Kang, Morris, & Tang, 2013; Ball, Jayaraman, & Shivakumar, 2012; Riedl & Serafeim, 2009).

3.1. Level 3 fair values: value relevance and information asymmetry

IFRS 13 “Fair Value Measurement” issued by International Accounting Standards Board in may 2011 with applicability from 1th January 2013 introduces a new definition of fair value as “*the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*” otherwise an “*exit price*”.

IFRS 13 provides also a hierarchy (“*the fair value hierarchy*”) in order to determine the fair value for reporting purposes: (i) Level 1 - unadjusted quoted prices for identical assets and liabilities in active markets; (ii) Level 2 - other observable inputs for the asset or liability such as quoted prices in active markets for similar assets or liabilities or quoted prices for identical assets or liabilities in markets which are not active; (iii) Level 3 - unobservable inputs developed by an entity using the best information available where there is little or no market activity for the asset or liability at the measurement date².

IFRS 13 and IFRS 7 also require extensive disclosure to help investors in understanding techniques and inputs adopted in measuring the fair value, especially when Level 3 inputs are intensively used. Following the introduction of FV hierarchy, many authors investigated on value relevance of different inputs adopted in application of FVA.

Lev and Zhou (2009) found that investors perceive as riskier securities measured through input of fair value of Level 3. Same results are reached by Song, Thomas & Yi (2010) to whom fair value of Level 1 and fair value of Level 2 are more value relevant than fair value of Level 3. Also Goh, Ng, & Young (2009), analyzing the effect of introduction of SFAS 157, found significant change in market prices depending on level of fair value; specifically, price is reduced for assets

valued using a mark-to-model, i.e. assets with lower liquidity and higher risk information due to the estimates carried out for evaluation. Also Kolev (2009) and Laghi, Pucci, Tutino, & Di Marcantonio (2012) found that all three levels of the fair value are significantly correlated with prices of the company shares.

Ayres (2016) focusing on relationship between different levels of input and firms' credit ratings found that an increased quantity of Level 3 fair value held by firms negatively impacts credit ratings. Author's results show that this negative correlation is greater for firm that have greater financial leverage, so any mispricing of Level 3 fair value would have the most impact upon financial statements of these firms. Moreover, interesting are analysis done by Siekkinen (2016) who studied how value relevance of different levels of inputs changes in environments with a different level of investor protection. In general author found a positive value relevance of fair value for all levels of inputs, with investor who are willing to pay more for assets evaluated in accordance with fair value than for assets evaluated at historical cost. Moreover, Siekkinen (2016) found a positive relationship between value relevance of fair value and investor protection. In a strong investor protection environment investors do not find any differences between market-to-market and market-to-model fair value. At the opposite, in case of weak investor protection results show how only fair value of Level 1 is value relevant and only this is reflected in shares' market prices, so in similar environment investor do not trust in fair value estimates provided by the firms. Lastly Roggi & Giannozzi (2015) analyzed impact of company liquidity risk, shown up in the three levels of fair value information, on stock prices during crisis periods. They demonstrate that investors have stronger negative reactions to companies with more Level 3 fair value in case of liquidity-constraining events. Indeed, in case of liquidity-expanding events investors react more positively to companies with more illiquid assets.

All the above mentioned literature, in accordance with our previous results (Tutino & Pompili, 2017) shows that use different levels of inputs to estimate fair value have some impact on how investor perceive value communicated by firms. Specially, fair value estimated with Level 3 input loses reliability due to the fact that investor are concerned with how management execute estimates and about possible errors or manipulations.

Furthermore, Level 3 fair value has been also associated with a major level of information asymmetry. Song, Thomas, & Yi (2010) found a general positive relationship between fair value and information asymmetry level that is major for fair value estimated with Level 3 inputs. Results obtained show a general investors suspicion about fair value measurement. Similarly Ball, Jayaraman, & Shivakumar (2012) found an increase in level of information asymmetry associated with use of FVA. Also Riedl & Serafeim (2009) found, in both cases, a negative correlation between Level 3 fair value and information asymmetry level. Authors attribute these results to disclosure requirement that, for them, are not strong enough to compensate the high information risk associated with not observable inputs used to estimate illiquid instruments. In addition Kisseleva & Lorenz (2016), investigating if Level 3 fair value disclosures provide useful information to investors, found that investors general do not rely on Level 3 fair value. Only Level 3 fair value that belong to the category of held-for-trading securities are reflected in firm value. Furthermore authors show as relevance of Level 3 fair value depend also on level of market sophistication and on information environment, so in market-oriented financial structure Level 3 fair values are more relevant as well as in case of firms that have experienced auditors.

3.2. Discretion of fair value accounting: any possibility for earning management?

In section 3.1 we have introduced problems arisen relating to Level 3 fair value, more specifically a lower value relevance of these fair value and a greater relationship with information asymmetry. Level 3 fair value is less reliable than the other levels due to the lack of transparency of estimates made with unobservable inputs. This lower level of reliability reflect invertors' concerns with possibility of manipulation made by management. Therefore, despite the aim of IASB and FASB to move toward a full FVA for financial instruments (and not only), academics and

professionals have various concerns with this accounting model yet. As stated by Benston (2008) “*the value to investors of fair values depends critically on how those numbers are measured and the extent to which they are trustworthy (i.e., auditable and not readily manipulated)*” (p. 102). Possibility of manipulations made by management in order to achieve their own goals has been object of various research conducted with the aim of understand if, under FVA, manager have both incentive and possibility for earning management behaviour.

Hereinafter are exposed, without any pretense of completeness, positions taken in literature about possible earning management under FVA.

Analysis start with those who found evidences supporting possible improper management actions carried out through distorted fair value estimates. Milbradt (2012) found how management might have some incentives in (i) keeping off markets some assets in order to avoid adverse balance sheet impacts and (ii) reporting these at inflated values using Level 3 fair value. Author refers to instruments negotiated Over-The-Counter (OTC) usually not transparent and without observable prices, so instruments that have the features for being evaluated with Level 3 inputs and also refers to bank, so to firms that have capital requirement to meet. Given these assumptions, in times of market downturn, firms might find convenient avoid evaluations made in accordance with mark-to-market principle in order to avoid write-offs and thus respect capital requirement.

Cheng (2012) investigates existence of discretion in FVA of "mortgage-backed-securities" before and after the introduction of SFAS 157-3 "*Determining the Fair Value of a Financial Asset When the Market for That Asset Is not Active*" on a sample composed of 889 bank holding companies from 2006 to 2010 (thus analysis includes 10 quarters preceding the new accounting standard and 10 next). This standard introduces more discretion in calculating fair value in case of inactive market and in case in which must be made large adjustments to observed market data. The empirical results show that with introduction of SFAS 157 fair value reported in financial statements for these instruments is subject to greater discretion.

Moreover, Dechow, Myers, & Shakespeare (2010) analyzing use of FVA for record securitization found how management use discretion when determine those values. In accordance with US GAAP, SFAS 140 request derecognition of securitized assets and recognition of an asset representing the "retained interest", rather the future cash flows received by securitized assets. For Dechow, Myers, & Shakespeare (2010) there are some problems in determination of fair value of the "*retained interest*", indeed management have possibility to exercise discretion over the basic assumptions of the assessment. Results of empirical research, conducted on a sample of 305 companies, of which 92 commercial banks, observed from September 2000 to December 2005, show how management acts on determination of discount rate for future cash flow in order to reduce the negative effects on income in case of loss from securitization. In this way management could reduce the gap existing between assets derecognized and the "*retained interest*", recognized after the operation and resulting from cash flow discounted at a lower rate, thus they reduce amount of loss to record in the income statement. Results also show that existence of incentive schemes can increase possibility of discretionary assessments made by management as well as inclusion of mechanisms for monitoring work of managers (e.g Independent directors) do not have any positive benefit.

McEwen, Mazza, & Hunton (2008) provide another interesting research, that is a second-level analysis with respect to those set out above. The authors do not address the possibility that management could provide manipulated estimates of fair value, but they analyze how financial analysts read biased estimates. In particular, they wonder if these parties are able to formulate prices that take in consideration the fact that the information provided by management, with specific reference to impairment losses, are incorrect. Results of their experiment, conducted through interviews of 44 experienced analysts, show how, despite analysts expect a possible manipulation given the discretion granted by the accounting standards and especially compared to inactive markets and unlisted instruments, they fail to adjust prices estimated to consider these distortions. From the study it is also clear how possibility of analysts who are not able to discount distorted

information is even more frequent when they are related to management with some type of incentive.

Quagli & Ricciardi (2010) provide an analysis about opportunistic use of discretion in accounting choice on a sample composed of 71 European listed bank holding companies. Authors focused on the Amendment to IAS 39 issued by IASB on 2008 that, in particular circumstances, allows reclassifying non-derivative financial assets out of fair value through profit or loss category. The Amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that could meet definition of loans and receivables, if the entity has intention and ability to hold that financial asset for the foreseeable future. Results show a relationship between probability to reclassify financial assets and past earning management behavior, so authors found that management use the discretion in accounting choice in order to avoid earning losses and in order to meet investors' and analysts' expectations. A similar analysis is done by Kohlbeck, Smith, & Valencia (2016). Based on prior research that show how management could use discretion given by Level 3 input, they investigate subsequent changes in fair value classification that result in net transfers into the Level 3 classification in order to examine whether firms use discretion to engage in opportunistic transfers. Authors using a sample composed of 733 bank-year observations from 2008 through 2010 found that managers are more likely to engage in transfers into Level 3 if the firm has incentives to engage in opportunistic transfers, but higher quality auditors appear to constrain this behavior. They also found evidence that auditors increase fees when managers transfer instruments into the Level 3 classification for facing the more auditing issue related to these type of estimates.

Fargher & Zhang (2014) investigate effects of Financial Accounting Standard Board (FASB)'s relaxation in application of standards on fair value measurement that has led to an increase of use of managerial assumptions to determine fair value. Authors' analysis, starting on a sample initially composed of 7.306 bank-quarter observations, show that increase in discretionary fair value measurements are associated with increased earning management behaviour. At the same point more discretion are also associated with a lower earning disclosure. General, the degree of subjectivity have to be taken into consideration in discussions about pros and cons of increased use of fair value in the accounting system. This because results obtained show how under adverse market conditions management have incentives to limit impact of fair value adjustments in order to avoid deterioration of shares' prices and to avoid to undermine stakeholders' confidence. Šodan (2015) conducts a similar analysis of Fargher & Zhang (2014) with the aim of understand the impact on earning quality of use of valuation techniques to estimate fair value instead of market price. He uses a sample composed of listed companies and banks from 17 Eastern European countries for period from 2000 to 2011, due to lack of market data he expects that companies in Eastern Europe more often estimate fair value with valuation techniques than companies operating in developed countries. Author found that these firms, with increased exposure to FVA, have lower level of earning quality due to the opportunity given to manager under this accounting system to manipulate estimated values. Indicator of some estimation bias are found also by Hanley, Jagolinzer, & Nikolova (2016). They, on a sample composed of insurance company, show that firms exploit the ambiguity in fair value hierarchy consistent with financial reporting incentives. Specifically, firms strategically report lower quality level of input to allow flexibility in fair value estimates, instead when firms are facing a decrease in liquidity they have the incentives to report higher quality inputs to communicate to the market better asset liquidity.

A recent research of Badia, Duro, Penalva, & Ryan (2017) investigates if firm exercise discretion over the fair value measurements exhibiting conditional conservatism when instruments subject to evaluation are not trade in liquid market. Authors raise attention to the fact that fair value is indicated by international standards setters as a measure generally unbiased that symmetrically incorporate unrealized gains and unrealized losses, but if firms introduce some discretion over measurements it became distorted. Furthermore, when instruments are not trade in liquid market investors apply a discount factor in order to consider possible optimistic or noisy fair value reported

by the firms. Considering this, authors predict that firms try to mitigate investors' discount of lower-level fair value measurements by reporting the measurements conditionally conservatively, i.e., by recognizing unrealized losses in a timelier fashion than unrealized gains. Further authors predict that more conditionally conservative fair value measurements are reported when there are more knowledgeable investors, when measurements are verified by more independent third parties, and when these measurements are disclosed more fully in financial reports. Authors consider also that firms which meet or beat earnings targets, an earnings management incentive that typically conflicts with conditional conservatism, report less conditionally conservative fair value measurements. Results obtained from a sample composed of 27.904 firm-year observations for period from 2007 to 2014 show as firms report conditionally conservative Level 2 and Level 3 fair value measurements, potentially mitigating concerns with unintended adverse consequences of FVA requirements.

In literature is also possible find who argues that the discretion granted to management should not necessarily be viewed negatively but also as an advantage. Discretion can be useful to better express real value of securities, especially for instruments not traded in active markets, for which there is no observable market price at the reporting date, for these instruments in fact information possessed by management should become essential for a better assessment (Laux & Leuz, 2010). A similar conclusion is also reached by Altamuro & Zhang (2013) that conduct an analysis on a sample of 82 bank holding from 2008 to 2011 that hold "mortgage servicing rights". Authors found that in case of illiquid market, despite the possibility of input manipulation, management provides high quality information exploiting information available to them due to their internal position. Moreover, Barth & Taylor (2010) suggest a different view of results obtained by Dechow, Myers, & Shakespeare (2010). For them authors' results do not have a unique interpretation. Earning management in fact could be a consequence of possible manipulation of values obtained through securitization, but it also might arise from discretion in choice of which assets to be securitized or from discretion in other general management decisions. For Barth & Taylor (2010) each of the above options could generate earnings management, albeit only one of these cases may be associated with the discretion in fair value estimates. Guthrie, Irving, & Sokolowsky (2011) propose another study on possibility of earnings management under FVA investigating on possible opportunistic adoption of fair value option in order to manipulate the firm's results. Fair value option is the possibility to measure at fair value, under certain conditions, instruments which according to their characteristics should be evaluated differently. Analysis is conducted on a sample of companies belonging to the index S&P 1500 observed in 2007 and 2008 and results obtained do not support concerns with opportunistic adoption of fair value option, as there are no evidence of such behavior, except in certain isolated cases. Finally, Goncharov & Zimmermann (2006) with reference to the German context, make a comparison between IAS, US GAAP and German GAAP in order to determine under which set of accounting rules result the lower possibility of earnings manipulation. The sample being analyzed consists of German companies listed in 2000 in the DAX 30 index, the MDAX and NEMEX 50 with the observation period 1996 to 2002. The authors show how under IAS and German GAAP level of possible manipulation is the same, while under US GAAP it is greatly reduced possibility of fair value estimate manipulation, and therefore possibility to manipulate firms' performance.

4. Fair value and dividend policy

Fair value, requiring alignment between carrying amounts of assets and liability and their market value, brings firms to recognize unrealized gains and losses. This components may alter income stability, with it that now depends not only on business's results but even on financial market trends. Problems arise not only regarding incremental income volatility but also regarding distribution of a positive income that comes from recognition of unrealized gains, because of these might be just transitory. Indeed, transitory income components if distributed could involve

damaging of capital integrity, and in this way generate procyclical effects that could reduce company's value.

Relationship between income effect of FVA and dividend policy has already been subject to some attention in literature.

Goncharov & van Triest (2011) examine relationship between positive fair value adjustment and changes in firms' dividend policy. Authors are concerned with possible procyclical effects introduced by FVA. For them, if fair value adjustments are transitory and managers are not able to assess their implications for future earning, include fair value adjustments in net income could have a procyclical impact because higher dividends increase leverage, and thus risk. Instead, there are not any problems if managers correctly assess nature of fair value adjustments and avoid to consider them in net income if they are just transitory and not persistent. Empirical research conduct on a large sample of companies from the Russian stock market (over than 4.000 firm-year observations during the period 2003 to 2006) has permitted them to exclude any problems in this regard. Results, indeed, show that there is a negative relationship between positive fair value adjustments and dividend changes which holds after controlling for dividend policy determinants and any endogenous nature of the revaluation decision. Therefore authors could exclude any procyclical impact of fair value adjustment on dividends.

De Jager (2015) based on Goncharov & van Triest (2011) examines increase in payed dividend relating to unrealized positive fair value adjustments on a sample composed of South African banks. Results show as these banks have increased dividends payment from unrealized transitory gains. Author shows that South African banks distributed a greater proportion of profits during the critical period of 2004 – 2008 when unrealized fair value profits from the banking book raised the level of bank profits. De jager (2015) affirms as this payment of dividend could be consider as one of the aspect for which FVA could be blamed to exacerbate recent financial crisis.

Chen & Gaviious (2016) on a sample composed of 508 Israeli public companies that adopted IFRS in 2007 observed for the period from 2001 to 2012 analyze impact of FVA on firms' dividend payout police. Authors affirm that firms could use dividend to give some signal to investors about reliability of fair value estimates, more specific *“To reduce the uncertainty (and increase the reliability) associated with its unrealized revaluation earnings, a firm could distribute some (or all) of these earnings as dividends, thereby signaling existing and potential shareholders and debt holders that it does not expect these earnings to reverse in the future”* (p. 218). Results obtained by the authors show as dividends payed before IFRS adoption represent 32% of realized earnings while after IFRS adoption dividends represent 115% of realized earnings. This increase in the percentage of payed dividends for authors is explained by amount of unrealized gains recognized under FVA. Results also show as firms that pay more dividends are more financially leverage and less innovative. Chen & Gaviious (2016) view this increased payed dividends as negative, because firm's real financial resources appear diluted, thus more payed dividends involve in an increased risk for all firm's stakeholders. Further firm's risk increase more in cases of dividends are based on unrealized earning that will not create real cash flow until they are realized. Chen & Gaviious (2016) therefore found that FVA, implicating distribution of unrealized earnings, could damage firms' financial stability.

5. Conclusion

Fair value was introduced by international standards setters, with the aim to provide information useful to investors in the decision-making process. In this sense FVA, linking balance sheet values at current market values rather than at values of past transactions, seems to actually increase comparability of financial reporting, both in time and in space. Despite that, in recent years many authors have criticized this criterion for its poor reliability. Indeed, although at a conceptual level fair value does not lead to any problems, many concerns arise related to its practical application, in particular in case of illiquid or inefficient markets. With regard to this aspect, IFRS

13, introducing inputs hierarchy and obligation of its disclosure, provides an indicator of reliability of assessments made in financial statements, thus investors could be able to correctly understand recorded values.

Much attention is paid to level 3 inputs, therefore to those unobservable inputs that are estimated by management using internal sources of information not shared with stakeholders. Many researches has been conduced in order to analyze possible manipulation of these estimates made by management but, how we reported in the section before, authors do not reach a unique conclusion.

The other issue related to FVA that has been analyzed in this paper is that, according to FVA, income statement shows a distributable income not equal to the realized one. To align carrying amounts to market values, firms might record unrealized positive fair value adjustments that could have an impacts in term of dividend policy and in this way might alter firms' risk and stability. However, authors do not reach to a unique conclusion also about it.

Although in literature a shared opinion about problems related to FVA application has not been reached yet, the many criticisms emerged must be considered. Certainly fair value is a complex criterion and develop consistent accounting rules in this area is challenging, but standard setters have to make some more efforts to ensure its correct application, especially when market inputs are not available.

Only by doing so information provided by financial reporting, prepared in accordance to FVA, will be preserved from possible distortions in order to achieve goal of standard setters of use a measurement method that help investors in decision-making process.

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Footnotes

- (1). The Conceptual Framework for Financial Reporting”, issued by the IASB in 2010, states as “the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. (IASB, 2010, §OB2);
- (2). Under US GAAP the main standard about fair value is SFAS 157 “Fair Value Measurement”. Fair value definition and guidance for its application (including input hierarchy) given by this standard are similar to those provide by IFRS 13.