
FAIR VALUE IN ACCOUNTING ESTIMATES

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Abstract: At the end of 2012 was adopted new IFRS 13 "Fair Value Measurement", which aimed to achieve greater clarity on the definition and use of fair value in the financial statements of companies. It gives a definition of the concept of "fair value", as well as ways for its determination and disclosure. With the standard did not change the requirements for the measurement and disclosure by fair value of items from the financial statement.

On the other hand in an international auditing standard 540 "Audit of accounting estimates, including accounting estimates at fair value and related disclosures" (ISA 540) is maintained thesis that certain accounting estimates are determined at fair value. In the same standard as an accounting estimate is determined the value of an object detected with some approximation in the absence of more precise and accurate means for measuring and valuating. It uses the hypothesis that the accounting estimate is an amount estimated at fair value resulting from uncertainty in estimating.

As a result of years of research of the author and after review of the applicable international or national legislation in the field of accounting and audit concludes that there are differences in the perceptions of accountants and auditors for fair value in the context of accounting estimates, which determines and the relevance of current study. The aim of this report is to bring out guidelines for practical distinction of the fair value of assets and liabilities of accounting estimates in preparing the financial statements of the nonfinancial sector. Based on a critical review of content aspects of these two accounting concepts offered their practical distinction for accounting and auditing purposes.

Keywords: fair value, accounting estimates, financial report.

СПРАВЕДЛИВАТА СТОЙНОСТ В СЧЕТОВОДНИТЕ ПРИБЛИЗИТЕЛНИ ОЦЕНКИ

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Резюме: В края на 2012 г. беше приет нов МСФО 13 „Оценяване по справедлива стойност“, чрез който се целеше постигане на по-голяма яснота по отношение определянето и използването на справедливата стойност във финансовите отчети на предприятията. В него се дава определение на понятието „справедлива стойност“, както и начини за нейното определяне и оповестяване. Със стандарта не се промениха изискванията за оценяване и оповестяване по справедлива стойност на елементи от финансовия отчет. От друга страна в международен одиторски стандарт 540 „Одит на приблизителни счетоводни оценки, включително приблизителни счетоводни оценки по справедлива стойност и свързани оповестявания“ (МСОС 540) се поддържа тезата, че някои счетоводни приблизителни оценки се определят по справедлива стойност. В същият стандарт като приблизителна счетоводна оценка се определя стойността на даден обект, установена с известно приближение при липсата на по-прецизни и точни средства за измерване и оценяване. В него се използва хипотезата, че приблизителната счетоводна оценка е сума, оценена по справедлива стойност, получена в резултат на несигурност при приблизителното оценяване.

В резултат на дългогодишни изследвания на автора и след преглед на приложимата международна или национална нормативна база в областта на счетоводството и одита, се стига до извода, че съществуват различия в разбиранията на счетоводители и одитори за справедливата стойност в контекста на счетоводните приблизителни оценки, което определя и актуалността на настоящето изследване. Целта на настоящия доклад е да се изведат насоки за практическо разграничаване на справедливата стойност на активите и пасивите от прилаганите счетоводни приблизителни оценки при изготвянето на финансовите отчети на предприятията от нефинансовия сектор. На базата на критичният преглед на съдържателния аспект на тези две счетоводни понятия се предлага тяхното практическо разграничаване за счетоводни и одиторски цели.

Ключови думи: справедлива стойност, счетоводна приблизителна оценка, финансов отчет.

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The theme of the fair value in accounting estimates initially found application in the International Audit Standard (IAS) 540 “Audit of Accounting Estimates, Including Accounting Estimates at Fair Value and Related Disclosures”. In the standard an accounting estimate is determined as the value of a given object established with some approximation in the absence of more precise and accurate means of measure and evaluate. Consequently, the audit standard explains the amount assessed at fair value when there is uncertainty in the approximate assessment or another amount that is as a result of approximate estimates. The result obtained from the accounting estimate is the actual amount that finds place in financial statements once the transaction is reflected by observing the conditions for its finalization.

If we juxtapose the accounting and auditing perspective, it would be found that in International Accounting Standard (IAS) 8 “Accounting Policies, Changes in Accounting Estimates and Errors” is used the term “change in an accounting estimate”³⁶. By definition it is “an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors”³⁷. After recent amendments to IAS “accounting estimate” continues to have no definition.

At the end of 2012 amendments to certain international accounting standards were published, and new ones were issued. With art. 1(d) of Regulation (EC) No 1254/2012 of the European Commission by 11 December 2012, in the Annex to Regulation (EC) No 1126/2008 an International Financial Reporting Standard (IFRS) 13 “Fair Value Measurement” is added. The purpose of the standard is the collection in one standard of specific guidelines for the determination of fair value for the unification of the understandings on its use in practice. It defines the fair value, gives guidelines about how it should be defined and requirements for the disclosures in connection with the way in which the same is determined are placed. At the same time the standard does not change the requirements for measurement and disclosure of the fair value of the elements of the financial statement.

The standard also determines that the fair value should be assessed on the basis of market criteria **and not according to the specificity of the individual undertaking**. For some assets and liabilities may be observed market transactions or may have market information. For others - such data may not be available. In both cases, fair value measurement is aimed at determining the selling price of an asset or transfer a liability in an orderly transaction between market parties in actual market conditions. It is recognized that it is possible for certain assets and liabilities to be used information from other market transactions, while for others - in the absence of such information. And because fair value is a market assessment, it shall be determined on the basis of the assumptions of any market players for the market price of an asset or liability, as well as account should be taken for possible risk tolerances of this price. In addition to the prices of an asset or liability, the indicated IFRS 13 “Fair Value Measurement” is also applied to the instruments of the equity capital of an enterprise that is measured at fair value.

The standard recommends compliance with a hierarchy divided into three levels in estimating fair value based on the nature of the source data:

Level 1: Listed prices in active markets for similar assets or liabilities (obligations) to which the entity has access up to the valuation date;

Level 2: Output data different from the quoted prices falling within Level 1 that can be observed (directly or indirectly) in transactions with similar assets and liabilities (liabilities);

Level 3: Unobserved data output for the asset or liability.

A significant difference can be highlighted in relation to fair value used for audit purposes and in International Accounting Standards in defining the concept of an accounting estimate. To be properly understood, the fair value should be considered in its two manifestations - as the value used in different methods of valuation at fair value and its manifestation as a fair price.

The valuation method can be used to estimate the price of the sale of an asset or to transfer a liability in an orderly transaction between market participants at actual at the date of measurement in market conditions. There are three well known widely used methods of valuation at fair value - the approach of market comparisons, the approach based on costs, and the approach based on income. For evaluating at fair value in a company from the non-financial sector can be used both separate methods and a combination of these methods.

The methods of costing at fair value measurement are applied consistently. Changes in the applicable method of costing or in the way of its implementation are possible if they lead to a fair value that is equivalent or one that is more representative under the circumstances. The following events could be mentioned as such examples:

³⁶ See § 5 by IAS 8 “Accounting Policy, Changes in Accounting Estimates and Errors”

³⁷ Ibid.

- development of new markets;
- access to new information or changes in the circumstances used up to now;
- improvement of the methods of costing;
- changes in market conditions.

The revision due to changes in the method of costing or its implementation is accounted as a change in the accounting estimate in accordance with IAS 8³⁸. In fact, this circumstance may lead to **confusion in the distinction** between the methods of valuation of the fair value and the change in the accounting estimate, although in IAS 8 is not required a disclosure of the change in the amendment of the method of valuation or in its application. With respect to the fair price, it should be added that there is a terminological mixing of the terms “fair price” and “fair value” (used in the applicable accounting standards). With a view to their similarity, namely, that this is “the price that would be received from selling an asset or paid for transferring a liability in an orderly transaction between market participants at the date of measurement”³⁹, it can be assumed that the two concepts are mutually interchangeable.

On the basis of the clarification mentioned above can be also explained the place of the fair value in its manifestation as a fair price. Grounds for this manifestation is the concept of fair value advocated in separate accounting and auditing standards. In addition to the data, available from various economic sources - exchange and market rates, prices and quotations, in practice are also used specialized assessments of identifiable non-current assets and liabilities, difficult for evaluation at market conditions. Normally, these assessments should be carried out by licensed valuers. On the other hand it should be taken into account that “according to Bulgarian accounting legislation, market price does not include the fair value but on the contrary – the fair value is a more general term that can exist in the form of market price”⁴⁰. A view is supported that “the removal of the cost of the sale of the fair price, changes the impartial nature of the evaluation by no means, but rather is set in accordance with the precautionary principle, compliance with which is mandatory, in order to be able to present a real accounting information about the property and the financial position of the enterprise”.⁴¹

In case of changes in accounting legislation, for instance after the adoption of the new Accounting Law (in force from 01.01.2016), undertakings which under the terms of the new National Accounting Standard 42 “First-time application of National Accounting Standards” wish to change its accounting basis from the International Accounting Standards into the National Accounting Standards (NAS), will be able to choose to evaluate the assets at their fair value at the date of transition to NAS, (for which this is allowed in NAS), as well as to use this fair value as adopted value at the date of transition to them. And as that change was prompted by the implementation of a new legislation, which is a change in an accounting policy, the use of fair value as a deemed cost compared to evaluation of the assets is not an accounting estimate because it uses market valuation. The deemed cost is the initial assessment which is not based on hypotheses and probabilities, but is reliable book value of assets.

The word “approximate” in the concept of “an accounting estimate” has the importance of inaccurate (tentative) dimension. Unlike the fair value, which is a **type of market assessment**, the accounting estimate has its own manifestation, which, although in itself contains hypothesis and probability, is subject to certain regularities. By them the characteristics of the manifestation of an accounting estimate are defined. According to the author, as a definition of the concept “an accounting estimate” should be understood a **valuable measure to reflect the managerial decision on expected economic benefit from the use in the economic turnover of a particular accounting subject, based on the available or new uncertain (approximate/ hypothetical) information, gained experience or a new interpretation of the facts, phenomena and processes relevant to the reliable determination of the carrying amount of an asset, liability or component of equity capital of the enterprise.**

On the basis of this definition, and taken into account the differences in the pithy aspect between “fair value” and “an accounting estimate”, a model is proposed for their practical distinction, based on a comparative analysis of key features that altogether define unequivocally the accounting estimate presented in table 1.

³⁸ See § 66 of IFRS 13.

³⁹ See § 6 of IAS 16 and § 9 of IFRS 13.

⁴⁰ Rupska, T. *Short-term biological assets as the subject of accounting reflection*, Scientific works of the UNWE, 2009, Sofia, University Publishing “Stopanstvo”, p. 162.

⁴¹ Rupska, T. *Short-term biological assets as the subject of accounting reflection*, Scientific works of the UNWE, 2009, Sofia, University Publishing “Stopanstvo”, p. 162.

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Table 1. A comparative model for practical differentiation between the fair value and the accounting estimate

№	Criteria for comparison	Fair value (evaluation)	An accounting estimate
1.	Nature of the used accounting information	Uses market valuations	Uses approximate assessments, hypotheses and probabilities
2.	Moment of occurrence of the assessment	Periodically after the initial assessment by a decision of the management of the company at occurrence of certain market conditions	Initially at acquisition of or after the occurrence of a certain condition (provision) following a decision of the management of enterprise
3.	Conditions for changes	Changed according to a decision of the management in the presence of certain market indicators in accordance with the applicable accounting standards	Changed after decision of the management of the enterprise according to the expected economic benefit
4.	Who prepares hypotheses	Market players	The management of the enterprise
5.	Who prepares the evaluation	An accountant and/or a certified appraiser	An accountant and/or an external specialist

As an additional argument for standing out of the fair value from accounting estimates may be presented the following clearly identifiable examples of accounting estimate derived under IAS (Table 2):

Table 2. Clearly identifiable examples of an accounting estimate

An accounting estimate:	IAS
Depreciation method	IAS 16
Residual value and useful life of the asset	IAS 16 and IAS 38
Choice of a functional currency	IAS 21
Cost of dismantling and moving the asset and restoring the site	IAS 16
Estimated costs for adjustments and work on warranty maintenance	IAS 11
Reclassification of an intangible asset with an unlimited life in an intangible asset with a limited life	IAS 38

The proposed clearly identifiable examples of an accounting estimate in table 2 fully satisfy the above mentioned definition, and show that inherently an accounting estimate is not a carrying value. When an accounting estimate is changed, it corrects the carrying amount of an asset or the amount of the periodic consumption of an asset, resulting from the assessment of the current status and the expected future benefits and obligations associated with assets and liabilities. It turns out to be a multiplier model of the original value at which asset or liability is entered in the accounts or is used in economic turnover. While the fair value directly focuses on determining the carrying amount of assets or liabilities. The Periodic comparison between the carrying amount and the fair value in market conditions is at the basis of ex-post assessments - revaluations or impairments of assets.

Attention should be drawn to the divergence in the perception of the accounting estimate and revaluations/impairment of assets at fair value. The clearest mark for their distinction is the moment of their occurrence. An accounting estimate is management discretion for the future economic benefits that are approximately assessed from the time of the entry into service of the asset until the revaluation and impairment are subsequent evaluations. When the revaluations and impairment are conducted at a later stage after the establishment of the accounting estimate of a specific asset, liability or component of equity, their timing coincides with the characteristics of a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". It is possible to appear some differences in the understanding and interpretation of the different concepts which can

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be seen from a different perception in accounting standards in terms of impairments and revaluations, which are based on approximations. They may cover or not the scope of activities, containing in them procedures for determination of an accounting estimate. This contradiction raises/gives raise to serious practical difficulties in the establishment of specific accounting estimates and the changes in them at a later stage.

In conclusion - it can be summarized that the fair value in the application of the IFRS/IAS is based on the need for faithful presentation of accounting information about the financial and economic status of the enterprise from the non-financial sector. Accounting estimates have a place in the financial statements of enterprises and have a different economic interpretation in relation to the fair value. The manifestation of fair value is not overlapping with the manifestation of accounting estimates, unless a fair value accounting model is used. Then they match the carrying value of the asset, resulting from the judgment of the management in determining accounting estimates and initial registration of the asset at fair value. The economic essence of manifestation of fair value and that of an accounting estimate is similar in meaning, but different in content, which is supported by the proposed comparative model and their practical interpretation.

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