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# The Decision Usefulness of Fair Value Accounting – A Theoretical Perspective

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I am indebted to Christoph Kuhner for his critical and insightful comments at various stages of this project. Also, the helpful suggestions of two anonymous reviewers and the journal's previous editor, Kari Lukka are gratefully acknowledged. Finally, participation in the European Accounting Association's 2002 doctoral colloquium provided useful comments at a very early stage of this project, and lent valuable stimulus to my research.

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<sup>4</sup> Thomas S. Kuhn in his 'Structure of Scientific Revolutions' extensively discusses this term in the context of scientific methodology and develops his influential theory of the process and drivers of paradigm shifts. While Kuhn's ideas have been subject to contentious debate, with himself backtracking on the definition, the general idea of a paradigm as a set of shared beliefs appears useful for tentatively conceptualizing the theoretical basis of fair value measurement.

<sup>5</sup> The implementation of the decision usefulness objective drew from the Trueblood Report. However, the foundations had been developed much earlier both in the academic and the standard setting sphere. Significant contributions involve the AAA's ASOBAT and APB Statement No. 4. For an historical overview see Hendriksen and van Breda ([1991](#), pp. 92–115, 126–131).

<sup>6</sup> See also SFAS 115, para. 40; SFAS 107, para. 39; SFAS 133, para. 220; and SFAS 157, para. C32. For similar conjectures in IASB pronouncements, see, for example, IAS 36, para. BCZ11; IAS 40, para. 40, B36; IASC ([1997](#), ch. 5, paras. 2.6–2.12); and, more recently and broadly in the context of initial recognition, IASB ([2005](#), paras. 99, 101–104).

<sup>7</sup> See SFAC No. 7, especially the section on 'Present Value and Fair Value' (paras. 25–38), and the observations on the evolution and implementation of the fair value paradigm in the following Section 2.3.

<sup>8</sup> For an excellent overview of the concept of fair value see [Hendriksen and van Breda \(1991\)](#) on the

<sup>9</sup> In an interesting paper, [Hendriksen and van Breda \(1991\)](#) argue that the concept of fair value is merely a device to avoid the recognition of assets or liabilities at their historical cost. In their view, the concept of fair value is a 'creative but empty' device. See also [Gelbach \(1991\)](#) on the 'creative but empty' device.

<sup>10</sup> The paper by [Hendriksen and van Breda \(1991\)](#) also discusses the balance sheet system and the system of fair value measurement.

<sup>12</sup>Former FASB member Arthur Wyatt refers to it as ‘possibly the most significant initiative in accounting principles development in over 50 years’ (Wyatt, [1991](#), p. 80), a notion emphasized by the testimony of SEC General Counsel James Doty to the US Senate, who made it clear that ‘the time has run out on “once-upon-a-time-accounting”’.

<sup>14</sup>For instance, market valuation of long-lived non-financial assets was well established in the USA prior to the Great Crash and the ensuing security market regulation in the 1930s (Walker, [1992](#), pp. 4–8). Although the SEC later prohibited such practice, the issue of market value accounting for certain items was discussed regularly in the USA as well as in other countries (Wyatt, [1991](#); Christie, [1992](#), p. 97).

<sup>16</sup>While (Barnett, 2008, p. 174) perceive measurement of development in an information system.

<sup>17</sup>A thorough understanding of financial reporting.

<sup>19</sup>It is not the aim of this paper to give a thorough discussion on the merits of normative vs. positive research approaches. Based on the arguments given, it is simply assumed that there is a case for a priori reasoning, especially with respect to standard setting questions. For a more general discussion, see Cushing ([1977](#)), Christenson ([1983](#)), and Watts and Zimmerman ([1990](#)). For an assessment of potential standard setting implications of empirical research, especially value-relevance research, see Holthausen and Watts ([2001](#)).

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<sup>22</sup>The (re-)emergence of the EBO model can therefore be seen as a ‘renaissance’ of the measurement perspective (Beattie, [2002](#), p. 109).

<sup>23</sup>For the distinction between economic income in a narrow sense and this ‘economic profit’ see Christensen and Demski ([2003](#), pp. 40, 50).

<sup>24</sup>Although, as pointed out, the frameworks elaborate no concept of informative earnings, several paragraphs hint at the notion of persistent earnings. See, for example, SFAC 1, para. 44; SFAC 5, para. 31; IASB Framework, paras. 28, 72–80.

<sup>25</sup>These results are turned upside down for residual income. Fair value residual income is constant in time and reflects the competitive advantage, that is, the fraction of sales that is earned on top of market expectations. Transaction-based residual income, on the other hand, increases in time and thus appears less indicative of the competitive advantage.

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