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An Experiment in Fair Value Accounting: UK Investment Vehicles

Jo Danbolt & William Rees

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historic cost income. However, in the presence of changes in FVA balance sheet values, income measures become largely irrelevant. This implies that there is no obvious advantage from adopting FVA income accounting if FVA balance sheet values are available to the user. Furthermore, FVA for our real estate sample is considerably less value relevant than for the investment companies and the evidence for this sample, if not conclusive, is consistent with earnings management. We interpret these results as confirming that fair values are highly relevant and largely unbiased where the values are unambiguous. Where valuation is ambiguous, which will normally be the case, value relevance will be lower and biased accounting may be revealed.

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Notes

 SFAS 157 requires that fair values be based on market prices available at the measurement date. If no market prices are available, either directly or indirectly, then fair values should be based on earlier drafts of SFAS 157. The author has applied to be designated level 2 if the valuation was based on market-corroborated inputs (such as

prices per square foot of similar buildings), or level 3 if the information was generated within the firm. For our purposes the distinction is not crucial. It is obvious that real estate investment assets are dominated by financial assets valued by reference to a quoted market.

In New Zealand, companies are allowed to recognise unrealised gains and losses either in the income statement or in the balance sheet revaluation reserve. Owusu-Ansah and Yeoh ([2006](#)) find no difference in value relevance of the two forms of recognition.

This paper also includes results for financial as well as tangible assets.

Since the adoption of International Accounting Standards by UK listed companies in 2005 (after the sample period included in our study), the accounting for investment properties is now governed by IAS 40 (IASB, 2003). IAS permits companies to choose between reporting property values at cost or fair value. Gains or losses (in fair values or upon disposal if a cost model is adopted) are to be recognised as income or expense in the income statement.

Before the 1995 SORP, most companies did not incorporate a columnar statement of total returns including capital returns, although the same information was typically included in the notes to the accounts.

While revaluation is not permitted for investment properties, the use of historic cost provides a more reliable measure of earnings. For example, it is usual to distinguish between earnings and interest on GAAP earnings. The earnings are charged to capital rather than to equity.

In this model, the growth of the portion of the element of the residual is the residual.

While the theoretical coefficients on opening and closing book value of equity to vary would provide useful

information. It could also introduce considerable co-linearity into the explanatory variables rendering interpretation of the results more difficult.

Running regressions with ni_{it} and ni_{it-1} is equivalent to incorporating ni_{it} and Δni_{it} . This transformation has no impact on the explanatory power of the model.

We conducted an audit for a sample of firm-years. This included a random sample plus an investigation of cases where alternative approaches to estimating the variables produced large differences. We found no cases where the estimated values of the reserves were misleading, but minor differences persist in our estimates of historic cost and fair value earnings. These occur where transactions are debited or credited to the relevant reserve accounts that are not relevant to the revaluation assets or the recognition of realised earnings. This is not uncommon, but usually trivial. However, where share repurchases were conducted by investment trusts, they could write off the premium on cancelled shares to the realised capital account. These amounts could be large. We have therefore excluded all investment trust cases from our sample where we have evidence of share repurchase activity (where 'share capital issued', Extel Ref = cfi.s, is negative).

The method for estimating the robust (rank) regression coefficients is an extension of the Mann-Whitney-Wilcoxon procedure. The procedure offers a robust, asymptotically distributed coefficient.

Although we often refer to the results as the same, they are consistent.

In the robust estimation. This is done by excluding observations.

Δr_v is significant. Beth



The γ_3 coefficients in the GAAP and HC models (as well as the γ_1 coefficient in the GAAP model) are significant under both OLS and robust regression techniques, although not under Fama–MacBeth estimation. The number of observations in some of the annual regressions for real estate firms is fairly small, resulting in somewhat erratic regression results.

There are 425 investment company cases (46.4% of the sample) with negative returns compared to 341 cases (37.3%) with negative niFV. There are thus almost 19.8% fewer negative niFV cases than we would expect from the changes in stock prices. For the real estate companies, the comparable figures are 164 cases (36.8%) of negative returns, but only 47 cases (10.5%) of negative niFV – a difference of 71.3%.



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