

Accounting and Business Research >

Volume 37, 2007 - Issue sup1: Special Issue: International Accounting Policy Forum

12,110

Views

202

CrossRef citations to date

4

Altmetric

Articles

Financial reporting quality: is fair value a plus or a minus?

Stephen H. Penman

Pages 33-44 | Published online: 28 Feb 2012

🗨️ Cite this article <https://doi.org/10.1080/00014788.2007.9730083>

Sample our
Economics, Finance,
Business & Industry Journals
>> **Sign in here** to start your access
to the latest two volumes for 14 days

🗨️ Citations

📊 Metrics

🖨️ Reprints & Permissions

Read this article

We Care About Your Privacy

We and our 843 partners store and/or access information on a device, such as unique IDs in cookies to process personal data. You may accept or manage your choices by clicking below, including your right to object where legitimate interest is used, or at any time in the privacy policy page. These choices will be signaled to our partners and will not affect browsing data. [Privacy Policy](#)

We and our partners process data to provide:

Use precise geolocation data. Actively scan device characteristics for identification. Store and/or access information on a device. Personalised advertising and content, advertising and content measurement, audience research and services development.

List of Partners (vendors)

I Accept

Essential Only

Show Purpose

Financial reporting quality: is fair value a plus or a minus?

Stephen H. Penman*

Recent deliberations by both the International Accounting Standards Board (IASB) and the Financial Accounting Standard Board (FASB) in the United States have focused on how fair values of assets and liabilities should be measured. The issue of *when*, rather than *how*, fair value measurement should be applied is still far from resolved, however. Fair values have been mandated for some assets and liabilities under both IASB and FASB standards, but it is fair to say that principles governing the applicability of fair values have yet to be articulated: when is fair value accounting appropriate and when is it not? Or, in terms of my charge for this paper, under what circumstances is fair value a plus or a minus?

To prepare for my task, I made a survey of public statements made for and against fair value accounting by a variety of standard setters, regulators, analysts, and preparers. The stated 'minuses' typically point to the dangers of fair value estimates from marking to model rather than marking to market, concerns about introducing 'excess volatility' into earnings, and feedback effects (on banks' lending practices, for example) that could damage a business and, indeed, heighten systematic risk. A few antagonists question whether fair values (for bank assets and liabilities, for example) really capture the economics of a business (in fostering core deposits and making loans). In counterpoint, the proponents of fair value argue that fair value is a superior economic measure to historical cost. Consider the following arguments, often advanced as 'pluses':

- Investors are concerned with value, not costs, so report fair values.

- With the passage of time, historical prices become irrelevant in assessing an entity's current financial position. Prices provide up-to-date information about the value of assets.
- Fair value accounting reports assets and liabilities in the way that an economist would look at them; fair values reflect true economic substance.
- Fair value accounting reports economic income: in accordance with the widely accepted Hicksian definition of income as a change in wealth, the change in fair value of net assets on the balance sheet yields income. Fair value accounting is a solution to the accountant's problem of income measurement, and is to be preferred to the hundreds of rules underlying historical cost income.
- Fair value is a market-based measure that is not affected by factors specific to a particular entity; accordingly it represents an unbiased measurement that is consistent from period to period and across entities.

So self-evident do these points seem to be that fair value accounting is often just presumed to be 'more relevant'. The words, 'fair value' sound good (who could be against ice-cream and fair value?!) while 'historical cost' sounds, well, passé. As it turns, out, however, each of these statements becomes qualified under scrutiny. Can economic argument lead to constructive arguments for implementing fair value accounting?

1. Some preliminaries

Pluses and minuses can only be evaluated against an alternative, so I will take the approach of asking if (or under what conditions) fair value accounting is an improvement over historical cost accounting. In discussions about fair value, people often pre-

*The author is at the Graduate School of Business, Columbia University. shp38@columbia.edu This paper draws



Log in

> Account

Log in

> Log in

Restore content access

> Restore content access for purchases made as guest


Purchase options *

Save for later

PDF download + Online access

- 48 hours access to article PDF & online version
- Article PDF can be downloaded
- Article PDF can be printed


USD 53.00

 Add to cart

Issue Purchase

- 30 days online access to complete issue
- Article PDFs can be downloaded
- Article PDFs can be printed

USD 183.00

 Add to cart

* Local tax will be added as applicable

Related



Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research

Help and information

- Help and contact
- Newsroom
- All journals
- Books

Keep up to date

Register to receive personalised research and resources by email

 Sign me up



✕