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A Study of Challenges and Prospects of “Fair Value Accounting” In India

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Abstract

Accounting data of excellent quality is a vital sign for accounting's true representation. “Fair-value accounting”, being an exercise of assessing assets and liabilities at estimations of the present values rose over the past twenty years. This is a radical change from the longstanding tradition of keeping comprehensive historical documents. The base of accounting,whether fair value or may be the historical cost, has important repercussions in the business community, impacting investment and management decisions. This has a significant impact on the broader economy.Fair-value accounting is only the messenger, and it would be foolish to "gun it down" simply because the message it is delivering now is bad. The basic goal of this study is to define the definition and importance of FVA. The article is significant since there is limited knowledge of the subject in the Indian context, and this research will raise awareness of the necessity of “FVA”. As a result, the main motto of the present study is to investigate the idea and significance of “FVA”, with the ultimate goal of emphasizing problems and future prospects of “FVA” in India.

Keywords Fair Value, Market Value, FVA, FASB, Historical Cost, IFRS.

Introduction

The quality of accounting data seems to be the essence of accounting, just because impartiality of audit is the main principle of the auditing. Accounting data which is of excellent quality is a vital sign for accounting's accurate representation. The differing views on incorporating FVA into accounting practice may result in high-quality accounting data. Those who accept the position argue that, because accounting is a pretended accounting information system, appraisal and hypothesis are inherent, and therefore measuring fair value has no effect on its dependability.

Dependability is just a matter of degree, and that there is no measuring feature that is unexceptional in terms of reliability. Those who disagree with the preceding viewpoint feel that it is exceedingly tricky for fair value to attain "fairness" since the surrounding environment and artificial estimation impact the fair value. Fair value had experienced tremendous challenges, particularly since 2008, when the financial setback erupted. Those in banking and politics are unanimous that accounting policy rules are an "accomplice" in this critical condition and that “fair value” standards worsen the financial crisis. In the course of the argument, opinions regarding fair value have taken many twists and turns. “The New Accounting Standards for Business Enterprises,” which were declared on the month of February in 2006, are mostly done, and people should apply “fair value measurement” openly to enhance the integrity of accounting data.

Historical Perspective

Marking to market was a common technique among bookkeepers in the USA in the 1800s. “The Securities and Exchange Commission” advised President Franklin D. Roosevelt to delist it, which was incorporated in 1938. However,” by the 1980s, the practice had extended to large banks and companies, and by the 1990s, mark-to-market accounting was causing controversies”. This has been criticized for contributing to the many recessions that led to the Great Depression and the bank failures.

Because as the practice of identifying the industry have become more popular among corporations and banks, it appears that some of them revealed that it was a pleasing way to perpetrate accounting related fraudulent, mainly when the market price could not be determined objectively because of the lack of a real day-to-day industry or the share price was inferred from many other commodities), so resources w The most infamous application of mark-to-market in this context was the Enron affair.

Following the Enron affair, the “Sarbanes–Oxley Act of 2002” introduced adjustments to the mark to market technique. The Act impacts the mark to market by requiring firms to adhere to tighter accounting rules. More clear financial

reporting, more excellent internal controls to prevent and detect fraud, and auditor independence were among the more demanding criteria. Furthermore, the "Securities and Exchange Commission (SEC)" established the "PCAOB" to monitor audits. "The S.O Act "also imposed more brutal consequences for fraud, such as increased jail terms and fines. Although the law was intended to restore investor confidence, the expense of executing the requirements prompted many firms to forgo registering on USA stock exchanges.

"The IASB" has issued "IFRS 13", that proposes the standard approach of determining "Fair Value.""FASB" created "SFAS 157", which addresses "Fair Value". "FASB" established a common definition of "Fair Value in SFAS 157" and a methodology for doing "fair value "measurement utilizing a tri hierarchy of inputs. Working on its convergence project, the "IASB" used the same approach to defining and calculating "Fair Value as SFAS 157" and announced "IFRS 13". In classifying the inputs used in measuring fair value," IFRS 13" uses a similar hierarchical framework. It is worth noting that India changed its standards and value of accounting by"IAS/IFRS" and would adhere to the same standard of accounting as specified by the "IASB". The following are the three-level hierarchical structures".

1. Excerpt Costs in the marketplace which are very active for the identified assets or may be the liabilities in which the entity may use at the measurement date constitute" Level one" input.
2. Processes that are not quoted market pricing are nonetheless visible for the asset or obligation, may be by direct or indirect.
3. Imperceptible input for the asset or obligation, which are generally and widely used to calculate "fair value "when observable inputs are unavailable.

Objective of the Study

With the fast expansion of the Indian market, whether accountancy reflection conforms to outside needs has increasingly become a hotly debated subject in the accountancy theory which is parting and real time practice circles. The quality of account data created via financial accounting is the primary problem of accounting reflection. As a result, this research was undertaken to investigate the idea of "FVA", with the ultimate goal of exposing the challenges and opportunities of "FVA" in India. The following are the paper's objectives:

1. To investigate the idea and importance of fair value as an accounting tool in India.
2. To discuss the problems and opportunities of "FVA".
3. To determine the steps that a company should take to solve the problems

Review of Literature

The particular study has a basis on a review of current relevant papers concentrating on "FVA". The following is an overview of some of the studies:

Sun's (2010) paper explains "fair value measurement"out of 04 typical and different perspectives. In the end, the "FVA " characteristic is for fix and variable property measuring, which is a type of inventiveness measurement from a lord - servant relationship. In reality, fair value measurement is a measuring procedure.

Swamy (2012) notes in the article critical areas on which the Indian banking industry must focus before and after the introduction of "FVA" and the implications for the bank's financial statements.

Ramanna (2013) highlights the importance of investment investment banking managing industry professionals in an"International Accounting Standards Board "on evolution of "fair-value accounting" in his essay. This Raised Actual prospect of specific amount of accountancy rules by finance related service sector groupings.

Jain (2013) investigates the acceptance of the "Fair Value Concept" in India. It also sheds light on the variables that might stymie the procedure in"International Accounting Standards"accounting systems which are becoming more similar and used in many developing nations, focusing on India.

Gunawardhana and Gunawardane (2014) conducted a study to examine the different challenges and obstacles to adopting "FVA" for "Real Estate Asset Valuation in Sri Lankan Publicly Traded Companies". Three objectives were created to attain this goal, and eighteen (18) hypotheses were generated and tested to meet the objectives.

The article by Salwalqa (2016) makes several innovative ideas that establish a specific standard,apex bodies, practitioners, and academicians throughout the

world should consider in order to secure a golden future for “FVA”. Furthermore, the study presents a list of prospective research paths in fair value and associated accounting standards.

Methodology of Research

The current article is conceptual and is entirely dependent on secondary sources. Various publications on forensic accounting at the national and international levels, working papers, e-papers, and media stories are carefully evaluated for this purpose.

Accounting For Fair Value

The concept of “FVA” is not new, and it arose primarily to address the constraints of historical cost accounting. A long-standing critique of historical-cost accounting (HCA) is that, while it can give helpful information about events that have previously occurred, it cannot tell us much about what actually held recently or what is expected to be held in the future. “FVA”the implementation of assessing assets as well as different liabilities at estimations of the actual value is on the rise over the past two decades. This is a notable shift from the centuries-orthodox practice of maintaining historical records. It also has implications in the blue-chip corporate houses due to the basis of the accounting thereby“fair value”might be historical cost impacts investment and, in the decision-making process, resulting in overall economic activity. The primary goal of "FVA" is to calculate the proper asset's valuation or obligation at the date of evaluation and to transcend the constraints of historical cost accounting in determining the exact wort of an asset or may be the obligation following the transaction price, especially in cases of impairment. In other words, “FVA” attempts to give a fair value to a company based on current market conditions.

“FVA” proponents claim that it enhances the usefulness of accounting information. Historical cost accounting, on the other hand, is regarded to be more prudent and reliable. “FVA”could be inculpated for various unsettledregular habits indicating up to the 1929 Wall Street Tragedy, and it was basically outlawed by the “US Securities and Exchange Commission” from the beginning of 19th century to the 3rd quarter of the 19th century. Financial setback that stuck in 2008, it was once again chastised. Many academic personalities and practitioners bridged the emergence of accountancy-related performance measures to banking institutions and other leaders' behaviour as in spin towards the incident. Mainly, when property values increased by 2008, the” fair value” also increased on some securitized assets held by finance related concerns were reported as minimal salary and, as a result, were used to calculate CEO bonuses on occasion. When asset values started falling and, lot of finance related masterminds condemned “fair value markdowns” for hastening the shrink.

Thus, it can be confronted that “FVA” is now a powerful, dominant system used to a significant extent by listed companies all over the world and has generated a great deal of controversy and debate among interested parties due to the existence of some difficulties in its implementation process, particularly as a balance sheet measure, and due to its alleged role in the international financial crisis.

However, in their respective jurisdictions, both “Generally Accepted Accounting Principles (GAAP)” in the “United States and International Financial Reporting Standards (IFRS)”, that have been took into the practice by nearly one hundred countries worldwide, continue to make extensive use of fair value. Specifically, during this time period, the concept that financial markets are efficient and that their existing prices are accurate gauges of value penetrated academic accounting research, prompting perspectives on the relative advantages of “historical cost” and “fair value” to alter. Fair value is a reasonable and unbiased evaluation of a good's, service's, or asset's projected market price in order to establish its worth in accounting and most schools of economic thinking.

Market Value Vs. Fair Value

The most recent edition of “Applicable Accounting Standards (IVS 2017)” makes a clear distinction between fair Value and market value, as defined in the IVS:
As a result, “Fair Value,” as the word is usually used, may be distinguished from “Market Value.” It involves determining the fair pricing between two specific parties, taking into consideration the different benefits or downsides that each will get from the transaction. Although “Market Value” may meet these requirements in

some situations, it does not always. When conducting due diligence on commercial transactions, fair Value is frequently used, where particular synergies between the two parties may suggest that the fair price between them is larger than the price that might be acquired on the broader market. To put it another way, “Special Value” may be created. When determining Market Price, Exceptional Value must be ignored, but it is taken into account when calculating "Fair Value."

Pros And Cons of “Fva”

Today, a business owner may select from several alternative financial reporting techniques. The “FVA” technique” is one of them. It enables estimating and reporting obligations and assets based on their estimated or real fair market value. As asset-liability varies over time, there may be unrealized profits or losses in assets owned by a businessman. The Fai Value Accounting technique can assist in measuring and charting such improvements. The transition to “FVA”(FVA)” has sparked heated discussion. Both proponents and opponents of “FVA” have been outspoken in their opinions. The following are the primary benefits of “FVA”:

THE BENEFITS OF “FVA”

Current information is used

“FVA” reflects current information on the balance sheet on the worth of assets and liabilities. This accounting approach contributes to greater accuracy in current values. If prices are projected to rise or fall, the Value might follow suit. Individuals and organizations can determine their precise position based on current market pricing. “FVA” is thought as much relevant for making an effective decision since it depicts more advance facts.

Consistent accounting standards

“FVA,” as contrast to historic total cost, which is not always accurate over a long period of time, accurately monitors all types of assets. Currently, financial accounting is based on a jumble of approaches are valued at their historical cost, whereas financial assets are valued at their present valuation as per the market. Because of conservatism, even for the same item, conflicting criteria are used. Under “FVA,” all assets and liabilities are expected to be assessed using a consistent and theoretically acceptable standard.

Comparability

“FVA”, suggested, would promote comparability by ensuring uniformity in the measurement of assets and liabilities. It will aid in the comparison of financial accounts from various companies.

No conservative prejudice

“FVA” contributes to the elimination of the present conservative bias in accounting. The elimination of conservatism is intended to enhance dependability due to neutrality, which is reporting information without prejudice.

True income calculation

There is less potential to falsify accounting data when using the “FVA” technique. Instead of relying on asset sales to determine gains and losses, price movements are recorded based on the actual or projected worth. Changes in income occur in tandem with changes in asset value.

Surviving in a lousy economy

The traditional technique allocates the same amount to an asset on the budget line each year. When the economy is challenging and prices are decreased, it becomes an onerous financial burden. “FVA” enables asset reductions inside that market, giving a firm a fighting chance.

THE LIMITATION OF “FVA”

Value fluctuations are extreme

In turbulent markets, the value of an item might fluctuate reasonably often. This causes significant fluctuations in a company's valuation and earnings. As a result, it may be argued that certain firms do not profit from this accounting style at all. These companies generally have assets that change in value significantly over the year. Furthermore, the possibility of incorrect values might lead to audit issues.

Less Dependable

The primary criticism leveled at “FVA” is that it is less reliable owing to a lack of neutrality. This issue is intimately linked to the type of inputs utilized. While no one can argue that Level 1 inputs are objective, Level 3 inputs cannot be said to be objective. Level 3 inputs are non-observable and rely on management assumptions. Many individuals are concerned that the widespread use of Level 3 inputs would undermine the credibility of financial statement data.

Changes in Book Value are frequent.

Historically, its book value fluctuated as it acquired new assets and sold existing assets. For apparently random reasons, “FVA” now alters a company's book value. Businesses that have specialized assets or investment packages may have difficulty valuing these goods on the open market.

Extreme income volatility

Excessive income volatility is one of the most severe issues associated with the fair value concept. As previously stated, income under the “ FVA” model is simply the net change in the value of assets and liabilities. Changes in asset “fair values” might lead reported income to become too variable. Because most of this volatility is due to changes in the “fair value” of assets and liabilities rather than changes in the underlying profitability of the business operations, income may become less relevant for analysis.

The historical perspective is lost.

Although current accounting is essential for evaluating, a wide grasp of what has occurred previously is also required to correctly monitor results. If the current market value of a certain item is not accessible, getting a fair value estimate meant to offer the most unbiased information is becoming more challenging.

Manipulation susceptibility

It is conceivable that the apparent market value of an item is not always reflective of the property's underlying worth. The market may be not efficient and fail to incorporate all publicly accessible information into its estimations. Other variables that might cause this market estimate to vary include investor irrationality, behavioural bias, and arbitrage issues. Managers' capacity to falsify financial figures would be significantly enhanced as a result. Again, this problem is directly related to the usage of Level 3 inputs, which are less objective.

The benefits and drawbacks of “FVA” indicate that, for the most part, organizations may have a transparent and reliable system of monitoring profit and loss. As long as investors are kept informed and are aware of what is going on, the advantages will usually outweigh the dangers in this case.

Recommendations

.Despite the disadvantages mentioned above, “FVA” looks to be a feasible approach. In order to provide more relevant information to financial statement readers, fair value information for all financial assets and liabilities should be included. Only level one of the “fair value” hierarchy, according to the previous explanation, can correctly determine the “fair value” of an asset or liability.As a result, the majority of the constraints of “FVA” are concentrated in level two and, in particular, level three. Based on this finding, the current study makes the following recommendations: First, the accounting authority should modify the accounting legislation and accounting standards in order to supplement and update the contents of laws and standards pertaining to fair value.

Accounting information transparency should be improved by reporting any uncertainty in the correctness of an element's fair value, as well as any processes used to validate such value, whether from the business itself or by auditors, particularly in the case of level 3 of the fair value hierarchy.

Collaborating with consumers and income statement standard setters to further examine the viability of the ideas and to demonstrate or deny the perceived merits of “fair value “ and“historic cost” based financial statement reporting for user analysis.

The global business environment should be enhanced in order to be more suitable for the dynamic market. This may be accomplished by assisting emerging markets in reorganizing their markets to be more liberal.

The present international accounting standards should be modified to make them more easily implemented. This would eliminate the present uncertainty in some standards by incorporating “FVA” as an inherent component of these standards.

“FVA” should be taught as a fundamental topic at all institutions across the world, with international accounting standards (IFRS/IAS) serving as a prerequisite.

The involved parties must be provided with all required training in “FVA” and associated standards (e.g. accountants and auditors). This task may be organized and carried out by standard-setters, who are capable of offering and explaining any confusing topics in various standards.

It is also feared in the Indian corporate sector that the implementation of the idea of Fair Value may diminish the value of these businesses' assets. The standard setters should conduct an awareness campaign to clear up this misconception.

In summary, infrastructure to enable knowledge, supervision, ensuring appropriate application of the idea, and offering training and awareness programs are some of the key aspects for effective "FVA" implementation.

Conclusion

"Fair Value" is a notion that is here to stay. Despite its drawbacks, standard-setters and practitioners are enthusiastic about the notion. Those who oppose "FVA" may have legitimate points, but the truth is that fair value reporting, in some form or another, is here to stay and will be extended. The "FASB" will gradually move toward fair market value, if only to improve comparability with foreign standards. As the gap between "US GAAP" and international standards continues to close, the usage of fair value is expected to grow.

There are several difficulties concerning "FVA", and many powerful forces are opposed to its implementation. It is quite evident that this notion is far from flawless. It is difficult to evaluate whether its contribution to accounting improvement is truly useful. On the one hand, there are several reasons why users of this approach are better off, but there are also numerous reasons why they are worse off. In reality, both extreme viewpoints are incorrect. "FVA" is neither ideal nor harmful in and of itself. Many tough philosophical and practical concerns concerning "FVA" remain unresolved. Meanwhile, all parties involved should learn more about "FVA" and strive toward a more successful implementation. Fair-value accounting is only the messenger, and it would be foolish to "gun it down" simply because the message it is delivering now is bad.

Note

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