APPROACHES AND CLARIFICATIONS ON THE IFRS 13 APPLICATION - FAIR VALUE MEASUREMENT

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Summary: *The objective of this article is to analyze the new changes within the application of IFRS 13 in order to solve a problem of "incoherence representative" between the financial statements, where certain asset components were presented at the fair value by the entities as suppliers and which, in turn, were presented as client entity. This assumed approach, in full knowledge of the facts was leading, obviously, to similar results.*

Keywords: *fair value; IFRS 13; evaluation.*

JEL Classification: M41

1. INTRODUCTION

As shown in the abstract, the purpose of this paper is to analyze and understand the standard IFRS 13 - "Fair value measurement", where the aspects/issues underlying the assessment of fair value of certain asset components in the financial situations are clearly delimited, with mandatory application from 1st January 2013. The reason to introduce IFRS 13 is that was desired the concise of all IAS/IFRS in the content of which was presented the fair value evaluation and, therefore, to establish the presence of a common standard, usable for all the reporting entities. Starting from US accounting standard that represented the basic principle to IFRS applied by the EU, the secondary objective of this paper is to refer to SFAS 157, developed by FASB, to can compare the two standards.

The main users of financial-economic information that will benefit from the advantages of IFRS 13 application, in the elaboration of annual financial statements, will be all the listed EU companies on a regulated market and implicitly the companies within our country.

The insertion/introduction of IFRS 13 is, basically, a part from a comprehensive process of accounting rules harmonization taking place internationally (especially between the IASB and FASB standards), but has the role to clarify, as well, certain accounting issues that were overcome/out-of-date in the current context of national economic development. In fact, it is known that there were different approaches of the fair value concept before applying IFRS 13, which cause many heterogeneous situations on the assessments made according to this criterion, situations which, obviously, didn`t favored, in any way, the comparable information in the financial statements.

The objective of the new standard IFRS 13 is not to impose new cases of evaluation application on the base of the fair value criterion, but is realized on the reorganization and systematization of all accounting materials on fair value, establishing a unique definition of fair value and providing more accurate information and data on the adopted valuation techniques and providing a greater range of information mandatorily reported. The subject (theme) of IFRS is particularly important today, not only because of its recent insertion/introduction, but due to the circumstances created by the assessments made on the basis of fair value parameter, during the last financial crisis. This evaluation criterion was challenged not only by practitioners but also by academics, because it was considered that reflects in financial statements, values that have contributed to the seriousness of certain

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situations, especially in the case of banking institutions. Besides these aspects, fair value theme is particularly interesting, given that it is still an unsolved problem in terms of the inability to evaluate this accounting method, in a manner to adequately reflect the values of the balance sheet position. This finding is often accompanied by the results of compared information, especially in terms of credibility and relevance, which the accounting doctrine proposes for fair value and other criteria, primarily, the historical cost.

In what follows we will make a brief foray on the standards that treat the fair value, evaluation criteria, presenting the methods of application (pre and post IFRS 13), identifying and highlighting the advantages and disadvantages arising from valuation at fair value of the accounting items in the financial statement. All these aspects will help us to understand whether the application of IFRS 13 is able to determine an effective improvement of the evaluation process, given that the evaluators' subjectivity remains a powerful element of influence.

2. IAS/IFRS STANDARDS AND THE FAIR VALUE

This part of the paper will present a brief foray of the IAS/IFRS accounting standards, emphasizing certain aspects of the historical evolution of their application, of the role that they had in the international harmonization process and especially of the effects that their use have generated on some issues, considered to be important; it is basically about the structure of income and so-called "value relevance" related to the information in financial statements, arising from their implementation.

The acronyms IAS and IFRS indicates International Accounting Standards, respectively International Financial Reporting Standards; first name refers to accounting standards published before April 2001; later, as a result of the organizational changes of the issuing entity, their name is converted to IFRS. International accounting standards are developed by the IASB (International Accounting Standards Board) which is basically the operators unit of the IFRS Foundation, an independent, private and non-profit organization (according to the official website of Tendazei this is defined as:"an independent not for-profit private sector organization working in the public interest" which aims the development of a single/unique set of accounting standards, globally accepted. The standards ensemble currently consists of 13 IFRS and 28 IAS, 8 SIC (Standard Interpretation Committee)[1] interpretations and a conceptual reference frame work; it is important to note that these standards are developed by the IASB quite frequently to substitute the old IAS.

The accounting standards IAS/IFRS have evolved in parallel with the globalization process of national economies, something which has led to an intensification of economic entities operating on international capital markets. This phenomenon has imposed the need to develop common rules for making synthesis accounting documents, allowing the reporting of comparable information, credible and timely. This information is basically the foundation for investment decisions for increasing the efficiency and transparency of financial markets (Di Petro, 2007; Saita, et al, 2002; De Angelli, 2013).

The need to resort to international financial markets has imposed to the economic entities to go through reconciliation processes of the summary/synthesis accounting documents, which in turn involved high costs, avoiding administration costs related to entering the international real estate markets. This reconciliation process of accounting rules among other countries has been recognized worldwide, imposing with authority in over 100 countries of the world; in this regard a particular importance had the development of IOSCO report and Basileea Committee. Regarding IOSCO, after a program initiated in 1995, had expressed a favorable opinion on the adoption of IAS/IFRS in 2000; Basileea Committee in

[1] SIC is the body dealing with the interpretation of IAS; like IASB this was reorganized in 2001. For IAS interpreted standards is used the SIC acronym (only for the standards that have been published before IFRS).

turn, had approved in 2000 a set of rules with a significant impact on the financial statements of credit institutions. These events led IASC to change its own organization - representing a foundation which includes not only representatives of the accounting profession, but also academics, financial analysts, investors, auditors and company representatives (Mates, Grosu & Socoliuc, 2008).

Other relevant events that occurred during the 2000s were: the introduction of the agreement with the FASB, to complete the process of convergence between IAS/IFRS and USGAAP and development of EC Regulation no. 1606/2002, which required the mandatory adoption of IFRS standards starting with 1st January 2005 in the preparation of consolidated financial statements of companies listed on a EU regulated market. Since 2008, the IASB began a process of standards revision which aimed the counteracting of the financial crisis, adapting the standards content, in particular of IAS 39 on financial instruments, to the existing economic environment.

In September 2005, the IASB decided on introducing a project that was intended to provide a single definition for fair value, to be common (valid) for all the IFRS and to group together in one document, all the techniques and different application areas of fair value. This project was completed in May 2011, by developing IFRS 13 - Fair value measurement, applicable to all the categories of financial assets and liabilities for which is provided their evaluation at fair value (is not developed just for financial assets and liabilities provided by IAS 39 and IFRS 9).

3. IFRS 13 APPLICATION – PROBLEMS AND IMPEDIMENTS

The objective of the new standard is to establish how fair value should be measured and not how to be applied. In fact, in this regard, it is stated that the standard will be applied to certain categories of assets and liabilities. According to IFRS 13, *fair value* is defined as the price that is charged to sell an asset or the price that is paid to transfer a liability, in the transaction between the contracting parties, on a reference market and on the evaluation date (according to IFRS 13 subparagraph A 473). Comparing the old definition of *fair value* with the new definition are found three significant changes, namely:

- firstly it does no longer refers to an exchange price, but to a selling price of an asset, meaning *exit price*;
- secondly it is introduced the concept of transfer (not only the *giving up*) of a liability;
- thirdly it gives a very clear defining of *market notion*

On first analyze, it appears that the fair value of an asset is its exit price. The above should not lead to relevant differences compared to the previous situation; but a discrepancy between this could occur if an asset is purchased on the primary market and resold on the secondary market. This discrepancy arises from the fact that on the secondary market exist differentiate prices between parties willing to buy (bid price) and parties willing to sell (ask price).

Regarding the new definition of fair value, is referred as in the previous statements, to the old price, knowing that in certain circumstances, an active market can be inexistent. If a certain instrument is traded on different markets, and therefore having different prices, is applied according to IFRS 13, the price of the main market (Quagli, 2011).

IFRS 13 applies a hierarchal fair value (this is introduced in IFRS 7 as well) but paying more attention to the quality of input data/information than to the valuation techniques. Therefore, the new standard requires that it should not choose the method of evaluation, but the method that provides a criterion for evaluation/measurement of fair value as much credible as possible. Despite this, IFRS 13 focuses more on data and less on evaluation methods, but this does not mean that the latter is invalid, but the contrary. Basically, IFRS requires the use of one of three methods:

a) Market approach - which consist of the use of prices and other relevant information concerning market transactions with identical or similar assets or liabilities.
b) Income approach - is based on the future revenues and costs transformation associated with an asset, in one value, been known as the discount/cash flow model. Assumptions regarding cash flow reflect both, market expectations and those of the entity.
c) Cost approach - based on the substitution cost; this approach can be valid only in the case of tangible assets and therefore does not apply to financial assets and liabilities.

Returning to IAS 39, in August 2011, IASB sent a letter with comments to ESMA (European Securities and Markets Authority) with a focus on definition of fair value of financial assets (not referring to assets classified as held to maturity and loans and receivables) given by IAS 39. Simultaneously, the IASB stressed that there were companies that did not determined correctly the fair value, determining it as the present value of future cash flows resulting from the planned restructuring, relying on internal evaluation models rather than using prices on markets, because these markets are considered inactive as well because of the unreliable prices.

In the letter drafted by the IASB, is stated the fact that the objective of measuring fair value, either using prices observed on markets or valuation models, is to establish a price at which the transaction occurs between the contracting parties, on a market, at the evaluation time. This objective can be achieved either by using the market prices or by determining a theoretical market price through an evaluation model.

The IASB letter ends with the exposure of several special situations arising (Berselli, 2010) from the models used to determine fair value, models that takes into account only the current value of cash flows provided by the planned restructuring and for this reason they might not comply with the requirements of IAS 39. The IASB also presents the difficulties in identifying buyers willing to update the titles that are based on prices which are determined using imposed valuation models. This situation, along with others determined IASB to the revision of IAS 39 accounting rule.

4. CLARIFICATION OF THE NEW APPROACH ON THE FAIR VALUE

The new concept of fair value promoted by IFRS 13 has the same traditional limitations: first, there is a great dose of subjectivity attributed to this value, aspects very easy to verify especially in the absence of an active market, case in which the determination of fair value is closely related, among other issues, to the context and characteristics of the subjects performing fair value measurements. There are some doubts about the credibility of fair value, even with/the presence of an active market, characterized by abundant liquidity and a much higher volume of trade. High volatility risks of financial titles, independent of the company's operational assets evolution/development, make that financial statements for a financial year (semester, quarter, etc.) to be difficult to develop, while contributing to a significant reduction of the fair value information capacity (Quagli, 2009).

So, given the markets in different countries, where there is a comparison between prices and values, we cannot expect a calculation of the fair value accepted by everyone and measured in the same time, which to ensure/guarantee the comparability and consistency of data/information in the financial statements because these values reflect economic contexts and different degrees of markets risk (Potito, 2012).

The main international accounting standards that include the criteria assessment of assets fair value are (before IFRS 13): IAS 16, IAS 40, IAS 38, IAS 36, IAS 27, IAS 28, IAS 31 and IAS 1, unlike current assets they do not provide a definition of non-current assets, which are subsequently identified (in a residual basis). A non-current asset is defined as an asset that does not include the following elements: assets achieved during the normal running of a production cycle, assets achieved in a period of less than 12 months from the date of financial statements preparation, assets held to be sold, cash on hand and equivalent means. (Incollingo, 2008).All of these standards refers to assets of non-current nature. The reason they chose only non-current assets is because in terms of balance sheet positions the transition to standards IAS/IFRS has had the greatest impact on them.

Within each accounting standard outlined above are highlighted possible alternatives regarding the evaluation of the same economic events, and how these options can affect the comparability of information in the financial statements, aspect which strictly contradict the objective of the accounting harmonization process pursued by the IASB.

Forward we will analyze the evaluation criteria previously imposed by the listed accounting rules, using short references to national accounting rules.

4.1. Tangibles assessment methods according to IAS 16

The accounting treatment on tangible assets is provided in most of the IAS 16 standard, excepting certain cases, depending on the economic destination of the assets being valued. Thus, there are tangible assets held to be sold (treated according to IFRS 5), real estate investments (IAS 40) and assets lease contracted (IAS 17). Economic destination of assets may vary from entity to entity and in time; therefore the same property may be the subject of application areas of different standards, due to different destination or after changing its destination in time. The distinction between tangible assets, real estate investments, goods as merchandise, is sometimes difficult to realize, because it is not correlated to the nature of the asset or as we mentioned to its destination within the entity.

The classification of an asset in one category or another, with the application of appropriate accounting treatment, requires sometimes a subjective assessment by the preparers, thing that require a different accounting treatment.

In the financial statements subsequent to initial interpretation of tangible assets, they can be evaluated by two alternative models, namely: cost model and fair value model. IAS 16 standard contains no preference for one of the two criteria and is not mandatory to choose one of the two accounting treatments for all the assets in the balance sheet, but remains mandatory the application of the chosen criterion for the entire class of assets (IAS 16, paragraph. 29).

We will insist on the fair value criteria – the subject of our paper- basis on this model it will be followed the periodic revision (checking) and the redetermination of accounting values of tangible assets to can adapt it to the market value (ex. IASB Part 6).

The revaluation process should be conducted regularly so that the accounting value to not differ in a significant way from the value which would be determined using fair value at the balance sheet closing. The frequency of revaluations depends on the variation (oscillation) of fair value related to the assets that are object to assessment. For those assets which recorded significant oscillations of fair value is required annual reassessment, while for assets whose fair value is less relevant, redetermination of the values can be performed every three to five years. If the fair value of an asset has been determined to an earlier date, prior to financial statements closure, it is necessary to calculate depreciation at the date of closing exercise.

In the previous definition of fair value (IFRS 13, paragraph BC 30, pp. B972) was not specified that:

- is not specify whether the entity sells or purchase the asset;

- it was unclear regarding a debt settlement purposes because it was not referring to the creditor, but to the stakeholders, in full knowledge of the facts;
- does not explicitly stipulate whether the exchange or settlement occurs on the valuation date or other date.

Among the impediments encountered in developing IFRS 13 was counted that the evaluators experts have identified possible differences in certain actions. For example, an exit price for an asset acquired or liability assumed in a business combination may differ from the exchange value if:

- the intentional use of an asset acquired by an entity defined by the most intense and best use by the market participants (than the acquired asset provides a defensive value) or
- a debt is assessed rather on the basis of its settlement with the creditor than on the basis of transfer to a third party, and the entity determines that there is a difference between those assessments.

In these circumstances, the current definition of fair value, in accordance with paragraph BC 36 of IFRS 13 is that it represents an current output price, but in the next paragraph of the same standard the problem of the moment when fair value should be used as a evaluation basis in IFRSs it is controversial, because there is a disagreement about the percentages:

a) which assets and liabilities should be valued at fair value (for example the fair measure in which the fair value should be restricted to assets and liabilities with prices quoted on active markets, that the entity intends to sell or transfer in the near future).
b) when those assets and liabilities must be measured at the fair value (for example the extent that based on the most intense and best use, IASB specifies methods for valuing assets on the basis of their defensive (the value associated with improving prospects other assets of the entity by avoiding the use of the assets acquired by competitors), and according to USGAAP that were still being prepared when issuing IFRS 13.
c) where have to be recognized the fair value subsequent amendments/amendments

4.2. The fair value hierarchy

IFRS 13 is a level 2 standard because it helps in identifying a fundamental parameter in the evaluation/measurement process, meaning the fair value, parameter involved in reviewing accounting evaluation treated in several standards. Before drafting the new standard, entered in effect on 1st January 2013, the definition of fair value was treated in many accounting standards; developing IFRS 13 allowed a higher proximity to US standard SFAS 157, signaling an important step in the convergence of accounting systems, meaning the international with the American.

Tabel no. 1 – Implications of IFRS 13 insertion

Addressed issues	Pervious Standards (IAS 16, IAS 32, IAS 39)	IFRS 13
Fair value definition	The definition attributed to the fair value was distributed in several standards	One standard
The fair value hierarchy	There is a postponement approaching to the US standard SFAS 157	One definition of the fair value
Evaluation process	No indication	Step by step indications on revaluation
Liquid or	No indication	Indicators which signals the

Addressed issues	Pervious Standards (IAS 16, IAS 32, IAS 39)	IFRS 13
inactive markets		presence of a inactive markets
Level 3	There is not any specific recommendation	Technical indication of evaluation
Main information to be provided		There is a special extension of the obligations especially if is used mark-to-model

Elements for evaluating a market as active or inactive consist of:

- the number of recent transactions;
- the ability of quoted prices to reflect the most actual information
- price volatility, in time
- presence of recent new emission;
- the presence of forced sales situations

IFRS 13 is using a hierarchy of three levels of fair value as follows (IFRS 13, Paragraful no. BC 166, 2013).

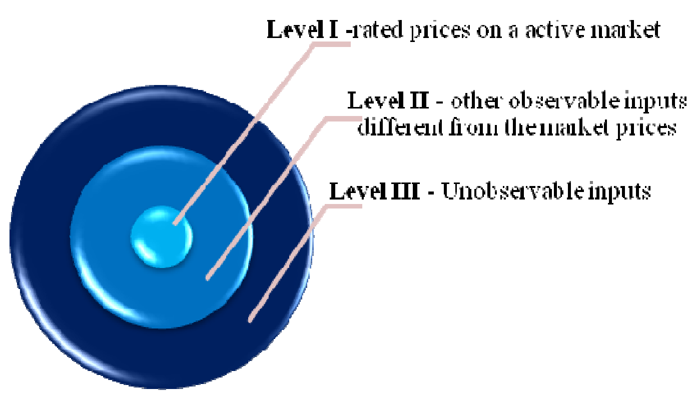

Fig. no. 1 Fair value hierarchy according to IFRS 13

Level I includes:

- first-level inputs, are prices listed on active markets on the evaluation date;
- these inputs are the best evidence of fair value;
- it derives from identifying the main and most advantageous market and the possibility that the entity can perform a transaction at that price;
- these prices do not require corrections.

Level II includes:

- level 2 inputs are those observable inputs, but different from the market prices;
- prices of similar items/elements, but not identical, exchanged on active markets;
- prices of identical items, switched on inactive markets, or on other markets, as the prices of final consumers, used with certain adjustments, to asses at a fair value the final products, in the producers headquarters;
- Other inputs such as interest rates or profitability assessment.

Level III includes:

- unobservable inputs;
- represented by the internal data of the company;
- they have to be used when there are no other inputs necessary for the evaluation;
- arise in the case of inactive or less active markets

- should reflect the exit price
- can be the inputs from internal or external sources, only if market participants proves using other sources.

5. CONCLUSIONS

The purpose of developing IFRS 13 was to unite all accounting standards, dealing with fair value criteria, in one standard; IFRS 13 is the first practical step towards IASB harmonization with US-GAAP. Defining the essential characteristics of SFAS 157 allowed the evaluation of the most important aspects, both in terms of similarities and differences of IFRS 13.

Basically, the most difficult to overcome obstacles, in applying the criteria of fair value in terms of IFRS 13 are represented by the following aspects:

- the complex nature and excessive extent attributed to the fair value
- high degree of subjectivity that characterizes this criterion;
- verifiability is difficult to realize;
- high volatility of data from the financial statements;
- low knowledge on the application of the fair value method;
- asymmetric outputs that characterize the results of the evaluation at the value versus historical cost;
- difficulties on application.

Developing IFRS 13 represents a significant contribution brought to IAS/IFRS current standards, given that convergence process with US GAPP will be rather difficult to achieve because the uniformity of calculations and assessments will continue to be an obstacle difficult to be avoided or overcome, because of the accounting origins of the two continents, in addition to different interpretations of those rules/normes generated by their translation.

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