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Fair Value Accounting in the Finance Sector: A Fiji Perspective

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In this paper we look at the applicability of fair value accounting in the finance sector of Fiji. We consider the perspectives of both the preparers and the users of fair value information from the finance sector. In looking at these perspectives, we took a sample of four banks and credit institutions and two investment companies. A questionnaire based survey was used to collect data from the preparers and users of fair value accounting information in the finance sector. Results indicate that the users perceive fair value accounting information as useful for their decision making purposes. Furthermore, fair value information is costly to be incorporated into financial reports, however, preparers do find fair value to be applicable and of relevance to them.

Keywords: Fair value, Finance, Accounting.

Field of Research: Accounting, Finance Sector.

1. Introduction

The concept of Fair Value Accounting (FVA) has been around for quite some time now. Accounting standards promulgated by the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) both contain FVA concepts. In turn many national standard setting bodies who adopted the standards promulgated by IASB have adopted the FVA. IASB (2007) defines FVA as “the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in arms length transaction”. Many of the standards issued by IASB contain this concept including International Accounting Standard (IAS) 16, IAS32, IAS38, IAS39, IAS40, International Financial Reporting Standard (IFRS) 2, IFRS4 and IFRS5 (White, 2008). However, there is a lacuna in the standards in regards to the theoretical justifications. None of the above standards contain a justification for the FVA except for the IAS 32- 1991 version only (White 2008). Recently, the concept of FVA has received its fair share of criticisms. Given the

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extensive use of FVA in the finance sector and the recent problems in the sector, FVA has been blamed for all the mess. The problems are further exacerbated by the fact that the current conceptual framework of accounting does not contain FVA concepts as a valuation or measurement system.

Research into issues of usefulness of FVA specifically in the finance sector is in its infancy. Issues related to the FVA in regards to Fiji have been raised in the local journal- The Fiji Accountant and there are discussions in the profession on the complications involved in the implementation of the FVA concept in Fiji. The issue of costs involved with the application of FVA had been argued to be high. Hence, it is time that we actually look at the issue of FVA from the perspective of preparers and sort out issues in regards to implementation of FVA. This seems an appropriate time to look at the issues such as the actual costs associated with FVA. From the perspective of users of FVA information, it has been argued that fair value information is relevant to users. Further arguments have arisen that FVA is less reliable. Hence, it seems an opportune time that we look at the usefulness of information prepared under the FVA concepts to the users.

Therefore, in this paper we will look at whether FVA in the finance sector in Fiji is considered useful from two perspectives-the finance sector as preparers of financial statements and as users of financial statements prepared using the fair value concepts. We undertake a survey based questionnaire analysis as part of this exercise. There were six financial institutions involved in this study. Of the six, four were banks and credit institutions and two were investment companies.

The paper is divided as follows; the next section looks at some of the prior research in the area of FVA and our research questions, the section after that looks at the methodology and the sample used in this study. Finally we look at the results and discuss the conclusions and implications of this study. The limitations of this study are provided at the end of the paper.

2.0 Literature Review

2.1 Fair Value Accounting

The concept of FVA became part of accounting standards from the mid 1980s. The accounting standard on Property Plant and Equipment IAS 16 was the first standard to promulgate this concept (White, 2008). FVA has been defined in various ways. Ryan (2008a) defines it as "a financial reporting approach in which companies are required or permitted to measure and report on an ongoing basis certain assets and liabilities (generally financial instruments) at estimates of the prices they would receive if they were to sell the assets or would pay if they were to be relieved of the liabilities".

In the period between mid 1980 and 2008 many other accounting standards have adopted the fair value concept as discussed in the introduction section. However, theoretical justifications for the selection of FVA have been lacking.

As stated earlier there was only one accounting standard (IAS 32-1991 version) which provided a justification for the concept which has not been amended and the justifications removed (White, 2008). White (2008) also outlines the theoretical justifications from that standard. The following paragraph is an extract from IAS 32 outlining the justifications for FVA as cited in White (2008):

> *"Fair value information is widely used for business purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgment of the financial markets about the present value of expected future cash flows in relation to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics regardless of why they are held and when and by whom they are issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decision to buy, sell or hold financial assets and to incur maintain or discharge financial liabilities".*

In September 2006, the Financial Accounting Standards Board (FASB) issued an imperative and contentious new standard, Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157), which provides significantly more inclusive guidance to assist companies in estimating fair values (Ryan, 2008a).The concept of FVA as it was promulgated under IAS 16 had been varied by each and every subsequent accounting standard using fair value concept (White, 2008). Accounting standards that necessitate or consent to FVA have increased significantly in number and importance in recent years.

"In the wake of the recent market stress, some market participants question whether fair value provides useful information for investment and credit decisions. Company executives contend that the performance measures produced using fair value create financial reporting that is misleading and disconnected from the reality of their business activities. They also said that it creates unjustified and unexpected economic effects, including covenant and regulatory capital stress and liquidity shocks" (Joseph-Bell et al., 2008). Generally financial institutions have criticized FVA, including FAS 157's measurement guidance due to the following reasons (Ryan, 2008a):

1. Reported losses are misleading because they are temporary and will reverse as market returns to normal.
2. Fair values are difficult to estimate and thus are unreliable.
3. Reported losses have adversely affected market prices yielding further losses and increasing the overall risk of the financial system.

On the contrary, fair value is said to provide useful information for investors compared to alternative accounting approaches because (Ryan, 2008a):

1. It requires or permits companies to report amounts that are more accurate, timely, and comparable than the amounts that would be reported under existing alternative accounting approaches, even during extreme market conditions.
2. It requires or permits companies to report amounts that are updated on a regular and on-going basis.
3. It limits companies' ability to manipulate their net income because gains and losses on assets and liabilities are reported in the period they occur, not when they are realized as the result of a transaction.
4. Gains and losses resulting from changes in fair value estimates indicate economic events that companies and investors may find worthy of additional disclosures.

While a number agree that fair value yields a more pertinent measure than historical cost, it is not perfect. Two controversies encircle fair value measurements today: (1) the application of FVA in illiquid markets, and (2) how and when modeling should be used as the method to determine fair value (PriceWaterhouseCoopers, 2008).

Companies providing credit protection through credit default swaps on the underlying asset, as opposite to insurance contracts, have been impacted by fair value measurements. Even though the non-payment that would trigger protection may not have taken place, companies are under the obligation to recognize unrealized losses on the contract seeing that the fair value of the underlying assets has considerably decreased. These losses provide bad news to investors that may at the end of the day be misleading. Therefore, these companies articulate that it is preferable to record only recognized gains and losses (PriceWaterhouseCoopers, 2008). According to Shortridge et al. (2006), "perhaps the root of the disagreement over a shift to fair value measurement is the philosophical debate over relevance versus reliability". They say that proponents of fair-value accounting argue that historical costs financial statements are not relevant because they do not provide information about current values. On the contrary, the fair value dissenters argue that the information provided by fair value financial statements is unreliable because it is not based on an arm's length transactions.

Also, IASB has recently acknowledged that the status quo on the application of fair values in financial reports is unsatisfactory. The IASB Board's fair value project has recently adopted the objective to 'establish a single source of guidance for all fair value measurements required or permitted by IFRS (White, 2008). The topical crises in the World's financial markets have resulted in financial institutions challenging the use of FVA to the point of calling for the withdrawal of the initiative (White, 2008). The finance sector was content to apply FVA when security values were escalating, with the effect of improved reported profits (White, 2008). The following section provides a discussion of the contentious issues in regards to the finance sector.

2.2 Fair Value Accounting in Finance Industry

The recent on-going financial crisis motivated some researchers to investigate the accounting cause of the problem. Many (we discuss these in the section on the perspectives from the sector itself) have argued that the use of fair values has largely led to this financial crisis. However, Ryan (2008b) argues otherwise. Academics have discussed several benefits and drawbacks of FVA in the finance sector. These discussions follow through in the following paragraphs.

Enria et al. (2004) identifies a number of advantages of Full Fair Value Accounting (FFVA). "FFVA would in principle lead to better insight into the risk profile of the banks than is presently the case, also in the light of the requirement to move many relevant off-balance sheet items onto the balance sheet" (Enria et al., 2004).

Chisnall (2001) argues that "fair value information about loans, securities and long-term debt provides significant explanatory power of share prices and returns beyond that provided by related historical cost values". This is because fair values are current or recent market value of the asset based on economic conditions. However, this is possible only in open, competitive markets or perfect markets. For financial instruments not having a competitive market, present values are used based on expected cash flows. Hence, fair value is regarded as conceptually superior (Chisnall, 2001).

Numerous research have identified that investment securities and loan's fair value provide incremental information relative to book values in explaining bank share prices (Barth 1994, Barth et al. 1996, Eccher et al. 1996, and Nelson 1996; cited in Landsman 2006). This implies that the use of fair values would be relevant to users of financial institution's financial statement as the incremental information will contribute by making a difference to the user's decisions.

Chisnall (2001) argues that accounting for loans on an historical cost basis better reflects the economic substance of the transaction. Customer loans are held to maturity or based on some contractual agreements. This determines the actual cash flows or any income earned over the period by banks or financial institutions. Hence, in such cases, historical cost would be relevant.

On the other hand, the use of fair values is away from the earning process. This value considers the current observed market price which is slightly away from the contracted future cash flows. With the use of fair values, gains or losses are recognized with short-term market movements. That is, unrealized gains or losses are recognized. Chisnall (2001) explains this as largely theoretical as commercial banks "could not realize directly the difference between the carrying value and the fair value of its loan".

However, O'Brien (2005) identifies that reliability is not an issue for securities fair values because market values are more readily available. However, in developing economies, the capital market is under developed and inactive (for instance, South Pacific Stock Exchange). Likewise there is no market in substance for loans and deposits (Chisnall, 2001) and for financial instruments comprising several embedded option like features (Landsman, 2006). Hence, it is difficult to observe the market price and high degree of estimation would be necessary. This would require significant assumptions as well. Thus, the use of fair values is not reliable in the finance sector as well.

Landsman (2006) identifies that the richness of securities markets, legal systems, banks and securities market regulatory enforcement and other institutional features differs considerably across countries. Therefore, "the effects on economic and informational efficiency of requiring FVA to measure bank performance and financial condition are likely to vary" (Landsman, 2006). Thus, the use of FVA would reduce comparability of financial reports across economies.

Enria et al. (2004) also states that the use of FVA could lead to lack of comparability. When there is no observable market value for an asset, valuation models are used. Enria et al. (2004) argues that currently a variety of valuation models exist with varied inputs and assumptions, which may significantly reduce comparability if used indiscriminately across financial institutions.

Since markets for all financial instruments are not active, Landsman (2006) explains implementation issues to arrive at the fair values. The fair value estimates of banks' assets and liabilities are likely to contain measurement error (Landsman, 2006). This is because fair values for all assets and liabilities cannot be observed from the market. Hence, a high degree of discretion is usually employed to arrive at the fair values. The use of fair values would yield unrecognized gains and losses that would cause earnings and regulatory capital to be more volatile than based on current historical cost model. This is possible if the measurement error in bank assets' fair values are not offset by measurement error in bank liabilities' fair values.

Ryan (2008b) describes the implications of the subprime crisis for accounting. Opponents[i] of FVA have tried to put blame for the subprime crisis on FVA. They justify by providing the "difficulties of measuring the fair values of subprime positions in the current illiquid markets" (Ryan, 2008b). However, Ryan (2008b) argues that "the subprime crisis is not and could not be the fault of any one set of parties". The "economic policy, bank regulation, corporate governance, financial reporting, common sense, fear of debt and bankruptcy and all of our other protective mechanisms were insufficient to curb" the crisis (Ryan, 2008b). Hence, the "subprime crisis was caused by firms and households making bad operating, investing, and financing decisions, managing risks poorly, and in some instances committing fraud" (Ryan, 2008b). Ryan (2008b) further argues that FVA have not worked perfectly during the subprime crisis. The crisis has made clear that preparers need further "guidance regarding how to calculate fair values in illiquid markets", users need better disclosures and "standard setters need to consider what guidance and disclosures to require" (Ryan, 2008b).

2.3 Fair Value Accounting in Finance Sector- A Perspective from the Sector

The fair value of a financial instrument represents the present value of its expected cash flows discounted at the current market rate of return, and it is considered to reflect all available information up to the measurement date. All financial instruments held by banks, including loans and investment securities are to be measured at fair value, with gains and losses taken immediately through income. In the wake of the recent market stress, some market participants question whether fair value provides useful information for investment and credit decisions (Joseph-Bell et al., 2008)

There are many reasons why the banking industry remains opposed to FVA. Skepticism about bankers' valuations is embedded so deeply that some observers who say banks are being forced only now to recognize the true value of their illiquid securities, also suspect that the companies could undervalue the securities they once overvalued (Davenport, 2008a). While the IASB clearly sees the fair value as the solution of the measurement related problems, few in the commercial banking community would concur (O'Kelly, 2008).

The banking industry opposition to the FVA is mainly on the grounds of the volatility in reported earnings that the FVA would generate. The reliance on fair value including for the assets that are not actively traded on liquid secondary markets, increases the risk that the information disclosed will embody artificial volatility. In addition, if these assets and liabilities held to maturity, the volatility reflected in the financial statements is artificial and can be ultimately misleading. In addition, Pollock (2008) argued that fair-value accounting has particularly perverse results when applied in the midst of a market panic, when markets are neither liquid or active, nor orderly.

Opponents of fair value point out its many practical difficulties, such as the uncertainty of what a fair price may be when there are no trades and no real bids (Pollock, 2008). Another concern raised in regards to FVA is that it will use inherently subjective valuation methods to determine the carrying value of a substantial proportion of the assets, and this will significantly affect the reliability of the financial statements. Charles (2007) argued that fair value is too often subjective and cannot be used reliably as a base on which to analyze past or future performance, including cash flows. Moreover, when fair-value accounting is dependent upon the prices of derivatives, when the cash market is not trading, it exposes the financial system to manipulation (Pollock, 2008). Davenport (2007) added that the fair-value model works for some business lines better than it does for others.

Even the corporate credit unions and their regulators argue that fair-value accounting's conflation of market, liquidity, and credit risk is distorting their true financial condition (Davenport, 2008b). Critics say that fair-value accounting could make it more difficult to realize value from acquisitions, or finance growth with debt (Fink, 2006). Using the fair-value method also would have a profound effect on loan-loss reserves, which have long been a touchstone for controversy in the industry (Davenport, 2006). This introduces volatility which is not something banks, their investors, or regulators entertain. In addition, some implementers believe that fair valuation of debt could lead to unwarranted or counterintuitive volatility in earnings from period to period that could be perceived to be at the whim of third parties such as rating agencies (White and Vakili, 2007). King (2003) elaborated that fair value is a very fuzzy concept and it does not provide better information for all users.

Davenport (2006) argued in support of fair value that it accurately captures the value of trading assets although banks may find it of limited use for conventional loan portfolios. Ernst and Young (2006) believes that in pursuing fair value, IASB is giving undue emphasis to what it believes to be relevant information and insufficient attention to whether the information concerned is reliable and understandable to users of financial statements. As fair values incorporate current information about current market conditions and expectations, they are expected to provide a superior basis for prediction than ousted cost figures can, since outdated cost figures reflect outdated market conditions and expectations (Poon, 2004).

The review of literature has provided us with many issues that plague the implementation of FVA. In relation to the issue of FVA in the finance sector, many articles in the professional journals have indicated that FVA is not applicable despite its areas of superiority. Due to these issues and the fact that there is a general lack of research in terms of determining the applicability and the usefulness of FVA in the finance sector in Fiji, we undertake this research. The issues identified form the basis for the research questions that we intend to answer through this research exercise. The next sub section deals with the formulation of our research questions which form the scope of this paper.

2.4 Research Questions

This paper looks at FVA as it is used in the finance sector in Fiji. The purpose of this paper is twofold, first we intend to look at the preparers' views in relation to FVA and the second is getting the views of users (in the finance sector) of financial reports in regards to FVA.

Hence there are two research questions that we intend to get answers for in this paper.

RQ1: Is FVA information useful to the users in the finance sector in Fiji?
RQ2: Is the FVA concepts applicable in the finance sector in Fiji from the perspective of the sector being preparers?

These two questions form the scope of the paper and through a questionnaire based survey we intend to find answers to the questions that we have posed.

In the next section we look at the research methods employed to answer these research questions.

3.0 Research Methodology

3.1 Method

We use a survey based approach in this paper. A survey seemed to be the most effective way of getting the responses from the participating individuals and organizations. We also held informal discussions with the participants. This was a questionnaire based survey and as a result data was collected using questionnaires. There were two sets of questionnaires: one for the users and one for the preparers. The questionnaire was administered by the researchers themselves (self administered) and some by e-mails.

The advantage of using a questionnaire survey was that it was easy to administer and it provided focus in terms of the data we needed to collect and only questions of interest to us were recorded and analyzed.

3.2 Sample

The sample used in this study was four banks and credit institutions and two investment companies operating in Fiji. These institutions are major players in the finance sector of Fiji. The sample of banks and investment companies used were selected out of a wider population based on the willingness of staff from the institutions to provide information. Initially phone discussion was held to verify the willingness of the institutions and the individuals for their participation in the survey.

4.0 Findings and Discussion

4.1 Users' Perspectives

We had administered questionnaires to six firms in the finance sector to collect information on the users' perspectives. In response, we got back four of the questionnaires. Hence this analysis is based on the four responses received. Three respondents were from the banking and credit institutions and one from an investment company. The questionnaires sent to insurance companies as users were not returned. In terms of the users, we are interested in whether the fair value information is useful to the users of the financial information in the finance sector in Fiji. We had intended to collect demographic data on the participating individuals and companies, however, all data on individuals were not provided as it was optional. The following paragraphs provide a discussion of the responses and the extent to which the users perceive the information to be useful.

4.1.1 Demographic Information on the Institutions

The following table provides basic demographic information on the institutions which responded and are included in this study.

Table 1: Demographic Data On Users

#	Name of Institution	Type of Institution	Years in operation
1	Home Finance Company	Credit Institution	44
2	Fiji Development Bank	Credit Institution	30
3	Westpac Banking Corporation	Bank	Not given
4	Fijian Holdings Limited	Investment Company	Not given

Source: Survey Information

4.1.2 Survey Response Analysis

The first question in our survey was on the definition of fair value from how the respondents understood it. Responses show that the fair value is quite widely understood as being the market value of an item as all the respondents replaced the term fair value with the phrase "the market value" in their response. One justification for this phenomenon would be that all responses for the users came from banks and credit institutions that make loan and investment decision and use the market values for collateral valuation and so on. Hence, they are more acquainted with the concept of market value. One user specifically responded that it is a current market value which is neither inflated by values nor understated through depreciation methods. This respondent had certainly taken the literal meaning of the word fair-as being free from bias. However, fair values are subject to biasness as highlighted earlier in the literature discussion. This is because estimations and personal judgments are involved. It is evident that the definition given by the respondents does not really correspond to what the standards say as mentioned in the literature review. This highlights a lack of awareness by the users of financial reports on what the full and proper definition of fair value is according to the regulators and standard-setters.

In terms of the use of fair value in their decision making, we had asked respondents whether they use fair values for some of the decision they make for example investment decision, loan extension decisions and so on. We found that three out of four users find fair value to be of use in investment decisions, sums insured for assets and finance extension purposes where extension of loans is a major concern repeatedly. This implies that most users rank fair values highly, probably due to its high relevance. As cited at Value Based Management. Net (2008) and proven by accounting research, "in today's dynamic and volatile markets, whether it is to buy or sell, what people want to know is what an asset is worth today". One user, however, did not find fair value to be of use in decisions on sum insured for an asset. One has to note that this is the perception of the individual representative of the firm. The user probably had this perception because he lacks understanding of FVA as discussed earlier. Another justification for this response from this particular respondent could be that due to insurance being a risky area in business, whatever information used for decisions here has to be very reliable. Since fair value is not very reliable as it involves exercise of judgment (as suggested in the literature review), it may not be considered useful for insurance decisions. This question is related to the third question where we asked respondents to specify whether there is other more appropriate and useful concepts compared to fair value accounting. We had listed conventional historical cost accounting as an alternative and an open alternative for them to list any other concept more appropriate or useful.

In was noted that three out of four respondents took fair value to be the most useful when compared with other measures such as conventional historical costs less depreciation for the decisions mentioned above. This is possibly due to the benefits relating to relevance of fair values and the fact that what matters to people is the asset worth today as mentioned above. However, one user found historical costs to be better particularly for decisions on sum insured for assets. This is again probably due to the lack of reliability associated with fair values as opposed to historical costs. The respondents did not identify any other concept that they find more appropriate or useful then fair value or historical cost.

The next question posed to the respondents was on how they understood the term fair value. This question was designed to provide us with evidence on the way in which fair value concept is understood by the respondents in comparison to what is exemplified by the accounting standards. Responses indicate that there is a difference in the understanding of the term fair value by the respondents. Each of the four respondents selected a different option from the options identified in the question. One understands fair value as an observation; the second respondent understands it as an observation of similar item. Likewise the other two had different perceptions; one being mark – to – model and the other replacement cost. This highlights a major concern for all that there is no common understanding among the users of financial reports of the term fair value in the finance sector. The issue here is how such a concept would be considered useful to users. Clearly it is vital to build up a common understanding of this concept among the users of financial reports before we are convinced that fair values are indeed useful to them.

In an attempt to substantiate the perception of the users in relation to the reliability of fair value information we had asked the respondents to state if they find it reliable. We found that 2 out of 4 users considered fair value a reliable measure while the other two respondents had the opposite opinion with one of these respondents adding on to say that it was only reliable depending on certain situations (with no elaboration on which “situations” he was referring to). Probably, his response was in relation to present values which involve estimates and therefore considered not as reliable as values obtained through observations from trading activities or observation of similar items.

All respondents had a positive response to the question on whether they thought that the application of FVA presented economic reality. Again, on this point it is important to note that "economic reality" implies knowing the real worth of assets or even the business as a whole. It is understood among respondents that fair values "fairly" reflect the true worth of items today. Hence, they have given an affirmative response.

Finally, all user respondents agreed that the use of FVA provides a 'true picture' of the firm with one respondent adding on that this really depended on the reliability of information about the fair values. It seems to be clear that users are cautious that fair value information they use are reliable, at least to a satisfactory level, so that they can use the information with confidence. Again, it is important to refresh on the benefits of FVA mentioned by Ryan (2008a) in the literature review section. The benefits mentioned by Ryan (2008a) are possible justifications for the responses received for the above question. Hence the responses received indicate to some extent that FVA provides information considered to be useful by the users of such information in the finance sector in Fiji. However, responses also indicate the wide understanding of the concept of fair value and the issue of reliability that is placed on fair value information. As a result we have answered the first research question of this research. The next subsection deals with the issue of FVA from the perspective of preparers in the finance sector, which would seek to answer the second research question of this paper.

4.2 Preparers' Perspectives

We had administered questionnaires to six institutions. We had received all the questionnaires back. Included in the six institutions were four banks and credit institutions and two investment companies. In terms of the preparers perspectives we were interested in whether the FVA concepts are applicable to the finance sector in Fiji. We did this by analyzing a number of factors including the cost associated with the application of FVA by the entities. We are again not able to provide demographic information in relation to the individuals who responded on behalf of the firm but we are able to provide such information at firm level. The following section looks at the demographic data.

4.2.1 Demographic Information on the Institutions

The following table provides basic demographic information on the institutions which responded and are included in this study.

Table 2: Demographic Data On Preparers

#	Name of Institution	Type of Institution	Years in operation
1	Home Finance Company	Credit Institution	44
2	Colonial National Bank	Bank	Not given
3	Fiji Development Bank	Credit Institution	30
4	Westpac Banking Corporation	Bank	Not given
5	Fijian Holdings Limited	Investment Companies	Not given
6	Yasana Holdings Limited	Investment Companies	Not given

Source: Survey Information

4.2.2 Survey Response Analysis

It is pertinent that before we begin the discussion on the findings from the preparers, we look at whether the companies included are applying IFRS and therein the FVA concepts. A quick overview shows that all the companies in the sample are using IFRS or IAS for their accounting and financial reporting. Fiji requires mandatory application of FVA from financial periods beginning 1st January 2008. However, it can be said from informal discussions with the individuals in the companies that they are well aware of the fair value concepts and that the companies are already applying this concept in financial reporting. In the following sub sections we present a discussion of the responses from our survey in relation to many aspects of the application of FVA in the finance sector from the preparer's view.

4.2.2.1 Costs to apply FVA

The first and foremost factor affecting the application of FVA in Fiji is the costs associated with valuing assets at fair value. Hence, we posed the question in relation to this perceived hurdle. All the respondents acknowledged that FVA is a costly affair for the company. The participants managed to identify some costs to the organization. Auditing costs and valuation cost were commonly identified as costs associated with the implementation of FVA. It was acknowledged by the respondents that auditing cost is significant. Auditing costs are increased as auditors have to do more work to verify the fair values which are less reliable then the historical cost. The lack of reliability of the fair values increases the risk for the auditor and as a result the auditor increases the audit procedures to reduce risk to an acceptable level. This incurs additional costs for the auditor which is passed on in terms of higher fees to the client. Valuation costs are also very high compared to conventional method where the amount for the balance sheet are derived from the documents readily available to the company hence requiring almost incidental cost of identifying the cost from the source documents. In relation to the fair value the firms will have to hire experts who will value the assets and liabilities of the entity. The market condition for valuation business will also change when all the firms required to report under IFRS try to get valuation experts for this task; their increased demand will lead to increases in fees as well. Thus, high cost for firms preparing reports using fair value models.

One of the respondents identified costs related to reclassification or regrouping of items to different account types in the financial statements for instance, the cost of reclassifying unrealized gains in the financial statements. This could lead to higher taxation if firms report higher profits due to the unrealized gains. There are other related costs as well. The reporting of assets at fair values if above the costs will lead to significant amounts being transferred to the income statement. Reporting high profits would put pressure on the management to pay higher dividends. However, the high profits may not necessarily display a fair picture of the organizations performance to its stakeholders. The profits would only be realized if the assets are sold and liabilities settled. However, accounting is based on going concern assumption implying that those profits may never be realized.

Another cost identified by the respondents was relating to system enhancements. Companies use accounting systems for preparation and compilation of accounting reports. Change to FVA would imply some changes in the accounting systems used. This involves costs and it also results in other related cost such as training cost. Changes in the system or the use of a new accounting system require employees to be trained for optimal use to enhance efficiency and effectiveness. Employees in the accounting and finance departments would require training to upgrade their knowledge on FVA and its application and implication.

A respondent identified that they incur very minimum cost due to the use of FVA. This company uses FVA only for securities. The fair values for securities are ascertained from the price listed by SPSE. This is further discussed later while discussing 'fair values for securities'. Hence, it can be said that the costs associated with the application of FVA concepts will be an issue for the firms. The survey also highlights the so called hidden costs such as education and training costs which would also have to be borne by the firms.

4.2.2.2 Benefits in applying FVA

The other factor that will influence the applicability of FVA concepts is the perceived benefits associated with the application of the concept to the preparers. Most common benefit identified by all the respondents is that the business and its stakeholders are able to know the current or actual net worth of the business. This was expressed by two of the respondents as follows:

"Knowledge of actual worth of the business (Assets, Liabilities)"
"You know the 'real' worth of your assets"

This is very important because the stakeholders are able to get a picture whether the business is growing in 'real' sense or not. Capital maintenance is an important phenomenon. It is important for business stakeholders to know whether the business has accumulated more capital compared to the same time a year ago. For instance, let us say an individual owns a building. He does not accumulate any asset or liability for a year. After a year, looking at the depreciated book value, the person has not been able to successfully maintain his capital. However, if fair value of the building has increased, then he is better off.

The other two respondents identified related views. The use of FVA provides relevant information which is not only vital for users but also for management. There is enhanced decision making as new strategies are used to further strengthen the net worth of the business. The relevant fair value information is useful for investment and financing decisions. Fair values may determine the extent of external funding the company is able to secure. The company may be able to get more debt financing if it has a higher value of assets due to FVA compared to historical costs. Companies would also gain from external equity financing. Improvement in the net worth of the company would provide a perception to existing and potential investors that the company is growing. As identified by a respondent, there will be “improvement in investor confidence”. However, we must also remember that the gains arising from the fair values are unrealized. It may be a tool used to mislead investors as well. One of the contentious issues in this regards was the use of mark-to-market accounting where investment companies were able to raise the value of their investments by trading on their own shares.

One of the respondents (from a listed company) identified that financial assets are also stated at their most current price which is determined by current South Pacific Stock Exchange price for listed companies. This is vital with regards to comparability which is improved. This is due to similar financial assets being recorded at similar values by different companies. Thus managements and preparers would be able to compare their financial position with another company holding similar assets.

The above discussions provide a dialogue on the perceived benefits of FVA information. In the next sub section we look at the issues related to fair value for securities. This question is more specifically related to the investment companies whose primary business is investment in other companies. However, it is not limited to investment companies only, as other types of companies in the sample also hold securities such as bonds.

4.2.2.3 Fair Values for Securities

In relation to fair values for security valuation, two respondents stated that they were not using FVA for securities. These respondents argued that security price are predetermined and it is usually held to maturity. Securities are kept as held to maturity due to the requirement of liquidity reserve by Reserve Bank of Fiji. The other respondents explained that fair values were used for security valuation. This is because the use of fair values has become mandatory as per IFRS. Respondents also argued that this would provide the ‘real’ worth of the securities held by the entity. Also, most securities traded by these (those who use fair values) respondents are listed on the stock exchange. Thus, these companies use the current listed price on SPSE as a basis for their valuation.

However, not all securities are listed and traded on the stock exchange. Two respondents[ii] explained that these securities are usually valued using present value analysis. These respondents recognize the extent of estimation involved in computing present values. Not only the future cash flows are estimated but also the discount rates are approximated. This implies the subjective nature of this method to ascertain fair values. This imposes a concern for the reliability of the security values on the financial statement.

The remainder two respondents explained that an independent valuation is conducted to ascertain fair values of securities not traded on the stock exchange. The valuations are conducted by third parties such as an advisory firm to determine the potential price. This method is preferred due to high reliability compared to other methods. Nonetheless, the costs are high as explained earlier.

4.2.2.4 Surrogates used for Fair Values

Respondents had differing views in this regard. Two respondents identified that market approach to valuations are used for the company. That is, the observed market price is used. Replacement costs are also used as a substitute for fair values. Observed market price for a similar asset is used as replacement cost. This approach has practical difficulties as it may sometimes be impossible to identify similar assets due to rapid change in technology. A respondent indicated that present values are used as a substitute for observed market price. Present value evaluation requires estimations. If present value estimation is too subjective (that is, when there is high uncertainty or variability in the estimated figures), then historical cost is used. Two other respondents identified that their companies also use historical costs as a surrogate for fair values.

4.2.2.5 Respondents view on the method which best reflects Financial Reporting

One of the respondents explained that the conventional accounting method best reflects the company's financial performance and position. This respondent considers conventional accounting practice superior to FVA due to the numerous drawbacks and limitations of FVA. The major drawback identified is the subjective nature of FVA. The respondent used the sub prime mortgage crisis as a point of reference to explain this. The respondent explained that if this company did apply FVA, it would have faced similar problems faced by other companies, especially in developed countries. Despite choosing the conventional practice as superior, the respondent identified that it lacks relevance due to the outdated values used for reporting.
The other five respondents were confident that FVA best reflects their companies' financial performance and position. These respondents had a common reason for FVA superiority. They explained that the company's financial reports are presented at the current price. This best reflects the

companies' true value. Respondents also identified that relevance is one of the most important characteristics of information. Since fair value information is more relevant compared to conventional practice, it would be more useful in decision making process. These respondents, who are for FVA, did acknowledge its limitations. Major limitations identified were the costs involved for FVA. One respondent explained its complex nature implying the difficulties involved in ascertaining fair values. The respondents also identified the uncertainties involved due to adjustments for non-performance and liquidity risks. For unlisted securities, personal judgments are used that is subject to biasness. Thus another major limitation identified is the lack of reliability of FVA.

The discussions in the preceding paragraphs indicate the preference for FVA. Hence, we can answer our research question posed earlier and the purpose for which we undertook this research exercise.

5.0 Conclusions and Implications

This research raises many pertinent issues in relation to the application of FVA in Fiji's finance sector. Through a questionnaire-based survey analysis, we were able to get feedback from preparers and users of financial reports in the finance sector on their perceptions and views regarding the applicability and usefulness of FVA.

The analysis indicates that the users of financial reports in the finance sector prefer FVA. Based on our analysis and discussions above, the major reason for this preference relates to the high degree of relevance of fair values for the decisions made by users. This is indicated by the users' responses that reveal that users value the true worth of the business and the current price of assets and liabilities in effective decision making. Similarly, the preparers indicate that FVA best reflects financial reporting in the finance sector in Fiji. This is again due to the greater relevance in comparison with other methods. The preparers also highlighted that it is important to know the 'real' worth of the business. However, the respondents acknowledged that FVA has a number of limitations. It has been identified that fair valuation is a costly activity with high valuation and auditing costs. Other costs include reclassification and regrouping of items in financial statements, system enhancement costs, and education and training costs. Businesses also use surrogates like present value, replacement costs and historical costs when it is difficult to obtain an observed market price.

Hence, it can be concluded that FVA may be applicable for the finance sector's users and preparers of financial information but we need to consider factors like cost implications and reliability of the information as well.

The most important implication of this paper is related to the education of users in relation to the fair value concept. Our discussions raised the issue of the respondents having different views on their understanding of fair value. This means that there is a general lack of understanding. Thus, this could impede upon the effective application of FVA concepts. This study provides important insights in to the application issues involved in FVA implementation as well as the use of FVA information in the finance sector of Fiji. There are a small number of firms operating in the finance sector in Fiji and as a result future research could look at doing a study including all the institutions which would provide a more complete insight into the applicability of FVA. There are also specific de-motivating factors in the finance sector in regards to the implementation of FVA. Future research could investigate these specific de-motivations. These studies would provide evidence in regards to the issue of FVA and its negative publicity given the current financial crisis that has been grappling the world.

5.1 Limitations

There are few limitations in this study as is the case for any research activity. These limitations include:

1. In regards to the sample for the users' perspectives, we had sent out questionnaires to 6 institutions, however, we did not get back questionnaires from 2 users. This may bias the results as the respondents who returned the questionnaires and who did not return may be different.
2. In regards to the use of questionnaire based survey, the disadvantage is that the respondents may not be motivated to give accurate answers or they may give answers that put them in favorable light.
3. Structured surveys, particularly those with closed ended questions, may have low validity when researching affective variables.

Endnotes

[i] These are mostly the writers who are practicing in financial institutions.

[ii] One of the respondents company does not use fair values for securities but the respondent gave his/her perception.

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