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REFLECTIONS ON THE APPLICATION OF FAIR VALUE IN ACCOUNTING PRACTICE

The integration of the Republic of Moldova in the European economic space makes it necessary to adjust the domestic accounting and financial reporting system. In order to fully comply with the contemporary market economy requirements, it is necessary to take over and adapt to the national reality the methods and rules of international accounting, including the valuation of the accounting elements.

According to the Law on accounting and financial reporting no. 287 of 15.12.2017, the valuation is a procedure of determining the value of the assets, equity, liabilities, revenues, expenses and economic facts of the entity [1]. The valuation is carried out in accordance with the National Accounting Standards (NAS), which are brought into line with the provisions of the Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings and those of the International Financial Reporting Standards (IFRS).

Currently, one of the most controversial types of valuation used in accounting is the fair value measurement. Among the most representative cases for which the NAS provide the application of the fair value are:

- receiving free of charge (as a donation) of fixed assets and inventories, if the input documents do not indicate the value of the assets received;
- subsequent measurement of tangible assets (assets in the form of fixed assets, land, property, plant and equipment in progress, investments property and mineral resources), if in accordance with the accounting policies the entity applies the method based on the revaluation model;
- the purchase of securities whose initial cost of entry, according to p. 57 of the NAS “Receivables and financial investments”, can be based both on the purchase price and on the fair value of another form of compensation provided [2];
- valuation at the reporting date of the securities accepted for trading on a regulated market (except the entities that draw up abridged financial statements and measure the securities at cost or adjusted cost);
- valuation of inventories received at the disposal / repair of fixed assets, and small value and short-term items, as well as of recoverable waste.

In the accounting regulations of the Republic of Moldova, the fair value is treated as the selling price of an asset in a transaction conducted under normal conditions between interested, independent and well-informed parties [2]. Thus, the fair value is determined on the basis of sales contracts, information on an active market according to its participants and the valuation date (if there are no sales contracts) and/or other credible information. If the establishment of the market price presents some difficulties, the price of the most recent transaction may serve as a basis for estimating of the fair value (as long as there are no significant changes in the economic environment between the transaction date and the valuation date). If for an asset (group of assets) there are no sales contracts or an active market, the fair value is determined on the basis of other reliable information (for example, the result of recent transactions with similar assets related to the entity’s activity) and represents the amount that the entity would receive on the reporting date after the sale of the asset (group of assets).

Some uncertainties in such situations may be caused by the choice of the valuation date and technique (method). Given this fact, we consider it relevant to develop the professional accounting reasoning. Thus, according to NAS „Intangible and tangible assets”, in the case of applying the revaluation model for tangible assets, revalued value is considered the fair value at the revaluation date less the amount of depreciation and accumulated impairment losses. The fair value of tangible assets, in turn, is determined based on their market value following the valuations carried out by independent evaluators or by a commission appointed by the head of the entity [2].

The decision taken regarding the revaluation will largely influence the objectivity of the obtained results. If the entity decides to carry out the revaluation on its own (by the commission empowered by the head of the entity), the members of the commission must know the main steps of determining the fair value taking into account the current state of the asset and the structure of the transaction (if any). These steps include: gathering the necessary information; the choice of the method (methods) to be applied; performing the necessary calculation procedures; drawing up the minutes regarding the determination of the fair value, based on which will be completed the accounting records.

It should be noted that there are no NAS that establish exhaustive rules that will allow a practicing accountant to make the necessary calculations to determine the fair value and measure the accounting items of the entity. Respectively, in order to apply the fair value measurement in the national accounting practice, it must be correlated with the provisions of IFRS. In this context, it is to mention that IFRS 13 „Fair Value Measurement”, defines the fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date [3]. In order to ensure the objectivity of the fair value measurement, the standard sets out the fair value hierarchy that divides the data needed for the assets or liabilities measurement into three levels:

- level 1 - refers to the assets and liabilities with the lowest degree of subjectivity in the valuation. The input information at this level includes quoted (unadjusted) prices on the active market for identical assets or liabilities, to which the entity has access at the measurement date;
- level 2 - provides the use of the gross input information for valuation, other than the quoted prices accepted at the previous level, which are directly or indirectly observable for the asset or liability;
- level 3 - involves the valuation based on unobservable inputs, used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date [3].

Therefore, the fair value hierarchy gives maximum priority to quoted (unadjusted) prices on the active markets for identical assets and liabilities (the input information at the level 1) that are acceptable for the valuation of financial assets. Minimum priority is given to unobservable input information (level 3) usually acceptable for the valuation of non-financial assets. Given that a large part of tangible assets has a low degree of comparability in the Republic of Moldova and an active market for intangible assets is missing, the valuation of these assets falls at the level 3.

The availability of the input information and its subjectivity can influence the choice of valuation method (technique). In fact, in the fair value hierarchy, priority is given to the data accepted for valuation and not to the valuation methods used to estimate the fair value [4]. Depending on the input information, accepted at a certain level, can be applied 3 methodological techniques: the market-based approach (uses prices and other relevant information generated by market transactions involving identical or comparable/ie similar assets, liabilities or a group of assets and liabilities, such as a business); the cost-based approach (reflects the value that would be necessary at a given moment of time to replace the service capacity of an asset, often called current replacement cost); the income-based approach (uses valuation techniques that convert the future values, such as cash flows or income and expenses into a discounted value).

Recognizing the advantages and disadvantages of the fair value measurement hierarchies and techniques, we are aware that they cannot be fully used in the current conditions of development of the national economy. The valuation techniques proposed the in IFRS 13 are heterogeneous in content. Their main types, grouped according to the possibility of obtaining objective information, are presented in a quite general form to be fully applicable to the reality of the Republic of Moldova. The existing impediments in this respect are related not only to the lack of respective valuation practices in domestic accounting, but also to the uncertainties regarding the future economic benefits, the difficulties in identifying the active markets for some accounting elements. Moreover, the choice and application of the discount rate does not have a unanimously accepted solution, being at the intersection of the interests of the accounting community and professional evaluators. As a result, the activity of accountants involves not only the search for alternative solutions, but also rather an analysis of possible risks and the choice between minimizing them and maximizing the possible results from the application of professional accounting reasoning.

Generalizing the above-mentioned facts, we consider that for a better understanding and application of the valuations used in international practice, it is necessary to develop and adopt, at national level, methodological and practical regulations for the valuation of accounting elements, including the methodology for determining of the fair value. We think that the application of the appropriate (relevant) basis for the valuation of the accounting elements will contribute to the formation of complete and reliable information about the entity's activity and its patrimonial situation.

References:

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