FAIR VALUE VERSUS HISTORIC COST: ADVANTAGES AND DISADVANTAGES

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Abstract
For any Romanian specialist who is in a high stage regarding the perception and understanding of international accounting standards, it is quite easy to realize that at their basis are two important categories of principles: the principles of recognition and the principles of measurement.
Recognition is the process of incorporating an accounting element in an entity's financial statements. This process is an indispensable process for the entity, but using the methods used within it, the entity may alter, "cosmetize" and artificially reinforce its financial ratios.

Key words: fair value, historical costs, tangible assets, financial reporting, national and international accounting standards.

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I. INTRODUCTION

Credibility is one of the most important features of the information provided by accounting, taking into account users' need for such information. Therefore, they must faithfully express the transactions and other events represented, as well as their effects. In ensuring the credibility of this information, assessment is an important element in achieving this objective.

There is a continuing dispute in terms of fair value measurement, given the abandonment of the traditional valuation base, namely historical cost. In the following chapters of this paper, the two conflicting evaluation modalities, ie historical cost and fair value, were presented.

Long periods of time have passed using this evaluation model until until the issue was raised that businesses needed another method that would be more of our day to achieve better accuracy, thus defending valuation at fair value.

II. FAIR VALUE IN IAS / IFRS

The use of fair values, or not, is a matter of high relevance, debated over recent periods, given the huge losses recorded by the large financial institutions that have resorted to the use of market values. This concept is closely related to the current economic situation, especially the international crisis, and considering this, many specialists in the field do not recommend using this valuation method because if its use is made at a time when the market is experiencing a number of difficulties, this method can lead to the recognition in the financial statements of significant losses and which are quite difficult to cover.

Therefore, it must be underlined and noted that the use of market values involves a number of problems, especially during extremely difficult times in the market, a situation that can not be denied or contradicted by anyone. However, there are also defenders of fair value, who use as a pro argument of this concept the fact that it is more reliable and has a direct connection with the reality, being connected to the real market conditions, considered to be better than the values obtained through other valuation methods, among which we can remember the historical cost method, with which they are in constant contradiction. So if we reflect the value of some elements in terms of their cost, that value would not give investors a good image as fair and accurate as possible of the problems currently faced by financial institutions.

For example, International Financial Reporting Standards (IFRS) require financial instruments to be valued generally at fair value. As the majority of those who face this term often associates it with the market price, the determination of fair value is closely linked to the existence of a market that has normal operating conditions, ie it must be sufficiently liquid for the price of financial instruments to be correctly established **(Stanadardele Internaționale de Raportare financiară, 2015).**

It is worth pointing out that one of the features of the current crisis is represented precisely by the above-mentioned aspect, by the significant decrease of the existing liquidity on the market, which led to the very depreciation of the value of the financial products. Therefore, the prices reflected on the market are not necessarily the real ones, which leads to the existence of an imperfect market.

International Financial Reporting Standards have been developed based on the perfect functioning of the financial markets, without questioning the possible effects of liquidity on financial instruments. Therefore, the fact that these issues have not been taken into account, fair value has begun to be increasingly criticized, thereby causing the IASB to amend the rules for the measurement of financial instruments at fair value.

In the following I will highlight the aspects that refer to the fair value, the definitions of this concept, presented in part in several IAS / IFRSs.

IAS 16 - Tangible assets

„ The objective of this Standard is to describe the accounting treatment for tangible assets. The principal issue in accounting for tangible assets is the identification of the recognition moment for those assets, the carrying amount and the related depreciation" (International Accounting Standard no.IAS 16 – Tangible assets)

With reference to the *Definitions* section of this Standard, the meanings associated with several terms are presented, but the term whose significance interests us as presented is fair value. Therefore, "fair value is the amount for which an asset could be freely exchanged between two knowledgeable, interested parties in a transaction carried out under objective conditions, with the objectively determined price " **(IAS 16 – Tangible assets)**.

Within this Standard, the cost definition is also presented, which has some link to the fair value, a link that can be regarded as a dispute between the two terms.

"Cost is the amount paid in cash or cash equivalents, or the fair value of other consideration for the purchase of an asset at the date of its acquisition or construction **"(IAS 16 – Tangible assets)**.

If we look closely at the two definitions of the two concepts, we can see with the naked eye that there is some connection between the two.

When an item of the nature of tangible assets will be purchased, this will also be possible through a total or partial exchange with another element of the same nature or another asset. The cost of that asset is determined at the fair value of the asset received in exchange, which should be equal to the fair value of the asset given up, and if it differs little, it can be corrected by the amount of any transferable amount in cash or cash equivalents.

IAS 32 – Financial instruments: presentation and description

The objective of this Standard is to prescribe some requirements for the presentation of the financial instruments that are included in the balance sheet and which identifies the information to be presented on the (recognized) balance sheet financial instruments, but also on the off-balance sheet (unrecognized) ones **(IAS 32-Financial instruments)**.

As it is well understood by the name of this work, the term of interest and that we are addressing in this work is fair value. In the Definitions chapter of this Standard, we have the definition of this term, referring to the classification of financial instruments in equity and debt **(Mateș and Socoliuc, 2008; Grosu et al. 2008)**.

Therefore, "fair value is the amount for which an asset may be traded, or the amount for which a debt can be freely settled between knowledgeable parties in the case of an underlying transaction. ” **(Mateș and Socoliuc, 2008; Grosu et al. 2008)**.

IAS 36– Impairment of assets

The objective of this Standard is to prescribe the procedures that an enterprise applies in order to ensure that its assets are recorded at their fair value, ie they are not recorded at a value greater than their recoverable amount. Regarding the scope of application, we can state that this Standard has a number of elements to which it applies but also a number of restrictions. As the theme of the paper is different, we will only focus on a segment of its application, ie those assets that are recorded at the revalued amount (fair value) based on other International Accounting Standards.

"Net fair value is the amount that can be obtained from the sale of an asset or a cash-generating unit voluntarily between knowledgeable parties in a transaction in which the price is objectively determined, less the costs of the disposal "**(IAS 36 - Impairment of assets)**.

IAS 40– Real estate investments

The objective of this Standard is to provide the accounting treatment of real estate investments and the related disclosure requirements. This Standard will apply to the recognition, measurement and presentation of investment property.

With respect to fair value, this Standard also refers to this concept and defines the fair value as follows: Fair value is the amount at which an asset can be traded between knowledgeable and interested parties in a transaction under objective conditions " **(Stanadardele Internaționale de Raportare financiară, 2015).**

IAS 41– Agriculture

The provision of accounting treatments and disclosures relating to agricultural activities are within the scope of this Standard.

The fair value is defined within this Standard as wel, a definition that is similar to the one presented in the previous Standard.

The fair value of an asset is based on its current condition and location. Determining the fair value of a biological asset or agricultural product can be made easier by grouping biological assets or agricultural products according to their significant attributes; for example, by age or quality. An entity selects attributes in accordance with the attributes used on the market at pricing **(IAS 41-Agriculture)**.

IFRS 3– Combining business

IFRS 3 has provided the following definition for the business combination: "merging of entities or individual enterprises into one reporting entity" **(IFRS- 3 Business Combinations)**.

"The Revised IFRS 3 and SFAS 141 (R) each use the same definition of the fair value that the IASB or FASB uses in the other standards. SFAS 157 defines fair value as "the price that would have been received from the sale of an asset or paid for the transfer of a liability in a regulated market transaction between market participants at the valuation date" and this definition is used in SFAS 141 (R) **(IFRS 3 - Business Combinations)**.

"The boards have recognized that the different definitions of fair value could lead to the different valuation of the fair value of the assets acquired and the liabilities assumed in a business combination according to the extent to which the combination is accounted for in accordance with revised IFRS 13 or SFAS 141 (R)" **(Grosu and Horga, 2008)**.

IFRS 7–Financial Instruments: Information to Provide

Most entities want to use fair value information because in this way they determine how they are financially positioned, but also the decisions that need to be made with respect to individual financial instruments. "Fair values provide a true basis for management evaluation by the management, by indicating the effects of its decisions to purchase, sell or hold financial assets and to hold, maintain or honor financial liabilities. The Board has decided that when an entity does not assess a financial asset or a financial liability in its balance sheet at fair value, it must provide fair value information by presenting additional information to help users compare entities on a consistent basis" **(IFRS 7 -Financial Instruments).**

IFRS 9– Financial instruments

Considerations on fair value measurement "The Council has endeavored to include in revised IAS 39 (published in 2002) extensive guidance on how to determine fair value, especially for financial instruments for which a quoted market price is not available. The Council has decided that it is desirable to provide detailed, clear and reasonable guidance on the objective and use of valuation techniques to achieve reliable and comparable fair value estimates when instruments are measured at fair value "**(IFRS 9 Financial Instruments).**

III. FAIR VALUE VERSUS HISTORICAL COST

Therefore, after the above, I consider that it is quite necessary to draw a subchapter of this paper that emphasizes the opposition link between the two concepts presented or referred to in almost all of the standards presented above.

The information provided by accounting to its different users must meet a number of characteristics, among which the most important one I consider to be credibility.

For a piece of information to be credible, it has to show a series of features (not to contain significant errors, not to be biased, to faithfully express the transactions and other events represented, but also their effects). When these elements are specific to the information presented by the accounting system of each entity, their users can be confident that the information in question correctly represents what it has proposed, or is reasonably expected to represent.

Evaluation is an important aspect of ensuring the credibility of the reported accounting information as this financial information is subject to a certain risk of providing a less credible picture than they should to serve as a basis for evaluation.

At present, accounting evolves from the historical cost system to that of the present value. The fact that historical cost assessments have been put into question lately is a concern for specialists in the field.

The search for alternatives to this valuation method aims to improve the quality of financial statements and, along with it, try to provide credible and relevant information to all users of accounting information. The use of fair value can make a significant contribution to improving the accounting information of their financial statements but at the same time may be subjective when it is estimated by those entitled to do so.

The value has been mentioned since ancient times, thus receiving, over the years, a lot of meanings, but each time an improvement of that meaning has been added to it. Switching from a cost-based accounting to one based on fair values was regarded as a conceptual transformation of accounting. For an accounting that is based on fair value, its objective should be to reflect the reflection of market values in the financial statements and its changes in the consolidated statement of the results obtained by the entity.

Regarding the above, it is quite clear that there are pros and cons of both assessment methods, therefore, in the future, it is expected the use of two evaluation bases, namely:

1. Historical cost - which is a fair value at the entry value;
2. Fair value - which is a subsequent assessment base compared to the initial one (for financial reporting).

There are clearly a number of people who are the followers of the historical cost method, but there are also a number of people who find it more adaptable to today's economy, which is constantly changing, the valuation method of fair value.

As can be seen, the use of any of the presented methods is only recommended if it is adapted to the requirements of today's economy. Each of them has a number of advantages and disadvantages, but they can also be accentuated or eliminated by the person who calls on them, and the interests it pursues.

IV. CONCLUSIONS

Fair value is assimilated to market-to-market. So, given the existence of an active market, the fair value is in fact the market price, and when the existence of markets is not questioned and they are effective, the fair value of a good corresponds, theoretically, to the present value of those cash flows that are expected to be obtained from the item in question in the future. Instead, when these markets do not exist or are inefficient, the fair value has to be calculated, which means calculating it based on a predictive model.

Although the fair value reflects the valuation of most balance sheet items, the historical cost retains its earned and well-defined status. The argument in favour of the above assertion is that historical cost can be used as a valuation method both for inventories, fixed assets, and tangible and intangible assets and operating assets.

Fair value measurement implies that an asset is ceded, and a liability has to be paid at all times. Fair value is considered to be the most appropriate measure to evaluate transactions from the day they occur because it reflects the reality on the market at that time.

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