

## GENERAL ASPECTS ON THE ACCOUNTING ESTIMATION- FAIR VALUE REPORT

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**Abstract:** : In the current context of the global economy, marked by profound changes, obtain as accurate a picture through financial reports is of undeniable importance and significance of the value is very complex. The result of the evaluation, the purpose of financial reporting, is, most often to express a numerical value for the item assessed. The fair value resulted because of the need satisfaction, expressed by users of financial statements, in that it had found a valuation model elements supporting the financial position and financial condition of the entity and to answer questions like: Do I have to do? I need to buy, keep or sell assets held? Current context encourages us to believe that fair value is a sustainable concept in financial reporting, taking into account the implementation of its upward trend in economic entities.

JEL classification: M41, G32

**Key words:** fair value, accounting estimates, financial reporting, historical cost

### 1. INTRODUCTION

Starting from the idea that determining **the fair value reflects an estimate and not only a finding** like in all the other estimation processes, it is necessary to express an opinion; we can say that the fair value resulted from the need of satisfaction expressed by users of financial statements, meaning that a valuation model of the elements supporting the financial position and financial condition of the entity had to be found.

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elements supporting the financial position and financial condition of the entity had to be found.

Fair value is the result of theoretical and practical search of different specialists for different purposes, but with the same goal: to express as accurately as possible the reality of an item's value at some point in time, after the initial recognition. ***Fair value is undoubtedly the most comprehensive term referring to evaluation. It is the result of different specialists' research in various fields using the evaluation process.***

**The concept of fair value** has aroused the interest of many theoreticians, practitioners and accounting standardization bodies that decide about its **definition**.

Another variant of the previous definition is *the amount of money for which an asset could be exchanged in a balanced transaction between informed and determined parties, other than in a forced liquidation sale* [6].

IASB gives the following definition of fair value: *the amount of money for which an asset could be exchanged or a liability settled, between knowledgeable parties, in a transaction that is objectively determined* (IASB, 2006).

According to experts [3], the fair value is a generic term, a goal, as the overall accounting objective is fair view. It is not a basis for evaluation included in the concept or some type of value. It is a purely accounting concept that professional evaluators and organizations representing them have tried to analyze and master, finding clear correspondences for it in practice.

Internationally there have been and there are still lively debates on the subject, especially regarding how to obtain the fair value. The term "fair value" is the translation of an Anglo-Saxon expression that literally speaking, corresponds rather to "honest value" or "loyal value" [13].

## 2. OBJECTIVES

Accounting standards do not provide an express definition of the estimation. We encounter, however, references to it in the standards. For example, in IAS 8 "Accounting Policies, Changes in Accounting Estimations and Errors", we find the following description: "As a result of the uncertainties inherent in the activities, many elements of the financial statements can not be measured precisely, but only estimated. Estimation process involves professional judgments based on the latest reliable information at their disposal. "

We find a definition of accounting estimations in ISA 540: "Accounting estimation is an approximation of a monetary value in the absence of a precise means of evaluation".

*Given these definitions we can say that estimation is the opposite of "exact determination." So, whatever the method, the reason or the method used to estimate the fundamental principle of estimation is the same: to situate the estimated values closer to the actual level of parameters necessary for knowledge at a given time, so the margin of error is minimum. In general, the estimate is synonym with the approximate.*

*Appealing to a brief foray into the specialized literature, we can say that in much of the books we find that measuring the fair value of an element is obtained by using techniques of estimation.*

Even if the IFRS presents the fair value as synonymous with the market value in evaluation standards, it is however a broader concept than market value. It turns up that in most cases of evaluation of the financial statements, the fair value may be based

on market value, especially where there is an active market. The "estimated sum" means a price in monetary terms payable for an asset in a free market transaction. This sum of money should be the best price that can reasonably be obtained by the seller and the most advantageous price reasonably obtainable by the buyer. This reasonable level excludes, explicitly, a price inflated or reduced by special conditions or circumstances [3].

### 3. METHODOLOGY

In the absence of a market price, the alternative is to use *estimation techniques*. In the category of estimation techniques we include: *estimating the various adjustments' value for impairment, approximating the utility period of assets and their residual value, assessing the percentage of progress of work in progress, estimating the usefulness of tangible and intangible assets in order to determine their recoverable value and hence, assets' impairment.*

Two approaches are specified in theory are given, namely [10]:

- analogy method which means to appeal to the market value of a similar asset, showing features identical or at least similar to the asset under review;
- valuing an asset by the use of modeling technique.

The method of determining the value of a good by analogy or similarity is theoretically valid but this is difficult to achieve in practice, since the notion of similar characteristics is often difficult to establish and prove.

The second approach to measure fair value uses a model at the disposal of the entity. Resorting to such technique we can say that we stand before a market to model valuation (by the reference to a model). We mention that, for both the choice of estimation models of elements that affect the financial position and their use, it must be first taken into account the nature of the item to be measured at fair value, timing and context of the evaluation and not least its purpose.

In Romanian practice, for many people, the concept of fair value knows only one reality: the market value. This is however only one way to estimate the fair value being the method which provides the greatest objectivity because it is based on external information that can not be influenced in any way by the entity. Thus, the fair value estimation process, as an alternative to the historical cost, involves the professional judgment by specialist assessors performing the operation, based either on the data collected from the market, or using their own modeling, where the estimated element is not traded in an active market.

Although it is considered that fair value reporting provides a better picture of the financial position than historical cost's option, however some experts characterize it as a highly subjective view because it is the resultant of estimations and approximations. This suspicion is generated by the fact the estimation procedure is up to company's choice based on the best practices of estimation known by it, without the user being able to know which is the ability of the company to make estimates and to distinguish fair value from other values.

In terms of the accounting estimation process, OMPF 3055/2009 also states that due to the uncertainties inherent in business activities, many elements of the financial statements can not be measured with precision but can only be estimated. Estimation

involves judgments based on the latest available and reliable information. For example, may be required estimates of:

- (a) bad debts;
- (b) inventory obsolescence;
- (c) the fair value of financial assets and financial liabilities;
- (d) the useful lives of depreciable assets or expected pattern of consumption of future economic benefits embodied in them;
- (e) warranty obligations

The use of reasonable estimates is an essential part of financial statements and does not undermine their reliability. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of subsequent information or experience. By its nature, the revision of estimation does not relate to prior periods and is not the correction of an error. A change in the measurement basis applied is a change in accounting policy, and not a change in accounting estimation. When it is difficult to distinguish between a change in accounting policy and a change in accounting estimation, the change is treated as a change in accounting estimate.

Effect of the change in an accounting estimation should be recognized prospectively by including it in profit or loss:

- (a) of the period the change occurs, if the change affects only that period, or
- (b) of the period the change occurs and future periods if the change affects both.

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Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events or circumstances after the date of change in estimation. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both (a) the current period and (b) the future periods. For example, a change in the estimation of the value of bad debts' accounts affects only the current period's profit or loss and therefore is recognized in the current period.

However, a change in the estimated useful life of a depreciable asset or the expected pattern of consumption of future economic benefits embodied in a depreciable asset affects depreciation expense in the current period and for each future period during the term of remaining useful life of the asset. In both cases, the effect of changes in the current period is recognized as income or expense in the current period. If there is, the effect on future periods is recognized as income or expense in those future periods.

An entity shall disclose the nature and value of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for disclosure of the effect on future periods when it is impracticable to estimate that effect.

If the value of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall mention that fact.

It is interesting that the evaluators in Romania have lately taken seriously the problem of defining value in terms of IFRS stipulations and the relationship that should exist between and evaluator and an auditor.

## 5. CONCLUSIONS

In Romania, as in other countries, the financial auditor is the person who basically confirms the fair values used by the reporting entity (if they are legitimately used and if properly measured). One problem is that the audited entities have not this independent arbitrator to confirm assumptions and measurements and therefore the entity will have information expressed in various assessments in its financial statements.

In Romania auditing standards require the adoption of international ones and therefore Romanian auditors are binding international standards (especially ISA 540 Audit of Fair Value) and the recommendations elaborated by the IFAC in October 2008 on the Audit of fair value in times of financial crisis.

However one thing is certain, fair value can not be blamed that led to the financial crisis or even to its deepening in Romania, because the number of Romanian entities using fair value was extremely small and Romanian regulatory institutions had developed rather conservative evaluation rules, which did not allow the use of optimistic assessment for value.

In conclusion, we consider that a professional accountant with expertise could successfully apply fair value with a minimal cost to the entity for which he is providing accounting services. Ensuring the objectivity of estimation can be guaranteed by the ethical standards set by a recognized professional body which the accountant has joined since this professional body is concerned with the audit of quality of its members' reporting [6].

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