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SURVEY: The View of European Professional Investors and their Advisors

Attitudes towards Fair Value and Other Measurement Concepts: An Evaluation of their Decision-usefulness

VALUE IN USE

FACE VALUE

FAIR VALUE MARK-TO-MODEL

HISTORICAL COST

FAIR VALUE MARK-TO-MARKET

LOWER OF COST OR MARKET

DRSC

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EFFAS

1 Executive abstract

1.1 Motivation

The increasing demand for world-wide harmonized principle-based financial accounting standards is driving the current development of a remodeled conceptual framework by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). One central objective in the development process of this modified conceptual framework is *to identify the measurement concepts which provide the most decision-useful information to the recipients of financial accounting information*. Thus, identifying the measurement concept or concepts suitable for financial accounting is of general interest to practitioners, standard setters and academics alike. While it is important to explore the different economic attributes of the competing measurement concepts, the question as to which measurement concept provides the most decision-useful information is predominantly an empirical question: Different users have different information needs and thus, favor and require different measurement concepts. Balancing the potentially conflicting user needs requires judgment. In order to provide this judgment, the standard setters need *information about the information needs and opinions* of different user groups. One of the central and most influential user groups is the group *of professional investors and their advisors*.

1.2 Study design and main findings

This *joint research project of the Accounting Standards Committee of Germany (ASCG), the Humboldt-Universität zu Berlin and the European Federation of Financial Analysts Societies (EFFAS)* addresses this research question. Using an online survey, professional investors and their advisors were questioned about their opinions in respect to competing financial accounting measurement concepts. Based on a *sample of 242 valid observations* from financial analysts, fund managers, institutional investors and rating experts this study finds that

- Respondents *rank financial accounting information as the most important data source* when providing investment advice or making investment decisions. Direct contact to management is of equal relevance but is consistently viewed as less reliable. Debt investors seem to use more detailed data from the notes of the annual statements while financial analysts tend to focus on quantitative financial statement data and apply a "one-size-fits-all approach" when analyzing companies.

- Investors *are familiar with historical cost accounting and mark-to-market fair value accounting*. Other measurement concepts, such as lower of cost or market, value in use, or mark-to-model accounting are significantly less well known.

- If *asked to give a general opinion* on financial accounting measurement concepts, the respondents, regardless of their background, *favor the consistent application of fair value accounting for all assets and liabilities*.

- This general opinion, however, does not hold for more specific questions. When *asked to rank explicit measurement concepts for different asset and liability groups*, the responses are much more diverse.
    - *For liquid and non-operating assets, mark-to-market fair value is considered to be the most decision-useful measurement concept.*
    - *For non-liquid and operating assets, historical cost and market-based fair value are not regarded as being significantly different in respect to decision-usefulness.*
    - *Mark-to-model fair values are regarded as significantly less decision-useful than both market-based fair values and historical cost measures for practically all asset and liability classes. Only for financial assets do respondents view mark-to-model measures as more decision-useful than historical cost values.*

These findings are tested for robustness by a set of extensive tests and should be *representative for European professional investors and their advisors who have an interest in financial accounting matters*. They clearly suggest that professional investors do not view fair value measurement as a measurement concept with a homogenous impact on decision usefulness. While they generally see market-based fair values as being (very) decision-useful, they rank mark-to-model based fair values as the least decision-useful measurement concept. Also, respondents differentiate between different groups of assets and liabilities when assessing the decision-usefulness of measurement concepts. Only for liquid and non-operating assets and liabilities do they clearly see market-based fair values as the most decision-useful measurement concept. These *findings put earlier results about the preferences of professional investors towards different measurement concepts into perspective*: While the general opinions given in this survey confirm the results from earlier studies, the detailed opinions for explicit measurement concepts and separate classes of assets and liabilities show a more diverse picture.

1.3 Implications for standard setting

Based on these findings, this study cautiously suggests that the *Boards should consider differentiating between mark-to-model and mark-to-market approaches in fair value accounting* when assessing the decision-usefulness of competing measurement concepts. Although this distinction is not easy to draw, especially with respect to financial assets, for most non-financial assets it is obvious whether a fair value was determined on a sufficiently liquid market or whether it is based on assumptions which are at least in part subject to management’s expectations. *Also, the decision-usefulness of different measurement concepts should be evaluated separately for different asset and liability groups*.