AARHUS SCHOOL OF BUSINESS
AARHUS UNIVERSITY

# EAA FINANCIAL REPORTING STANDARDS COMMITTEE SYMPOSIUM

## FINANCIAL INSTRUMENTS AGENDA PROJECT

GÜNTHER GEBHARDT,
ARACELI MORA,
FRANK THINGGAARD,
ALFRED WAGENHOFER

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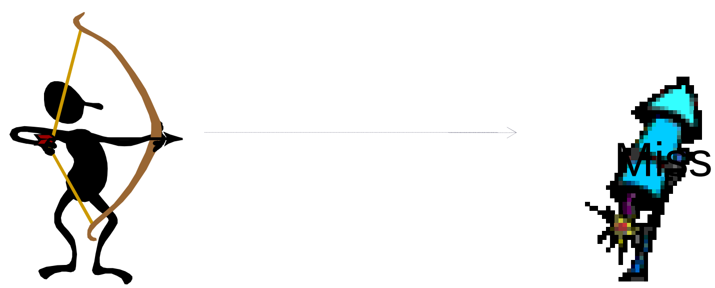
# FINANCIAL INSTRUMENTS AGENDA PROJECT

- IASB’s process very fast => difficulties in keeping pace
- First attempt was at the DP on Reducing Complexity
- Tried again to collate research findings for the ED on Financial Instruments: Classification and Measurement




- Current status: We try to develop a position paper based on previous research

# HIGHLIGHTS LITERATURE REVIEW

**Empirical accounting research on financial instruments**:

- **Fair value accounting** is central to discussions about the accounting for financial instruments and reductions in complexity
- Major part is from the **banking sector** – Still an open question whether findings from this industry can be extended to non-financial industries
- Much research is **US based** – Little European evidence – Still an open question whether findings from the world's largest capital market can be extended to other countries
- **Lack of new evidence**: much research initiated by the discussions and subsequent adoption of SFAS105 (1990), 107 (1991), 115 (1993), 133 (2000)
- **Investor perspective** /valuation approach – still an open question whether different user groups have different views on the issues

# HIGHLIGHTS EMPIRICAL STUDIES

Does fair value accounting provide useful information for economic decision making?

**Mixed results** – but a **majority** support that fair values are informative to investors

Fair value adjustments increase **earnings volatility**
– no definite resolution of whether this is good or bad

Measuring at fair value financial assets which the firm intent to **hold to maturity** seems relevant to investors

– but fair value **disclosures by security type** seem to provide distinct information

Risk of **earnings management** and less reliable financial statements when fair values must be **estimated**
– but it seems as if the market is able to see through such attempts

# HIGHLIGHTS EMPIRICAL STUDIES

A reduction in the number of fair value changes that **bypass the income statement**
seems positive

**Recognition and disclosure** does not seem to be substitutes when recognition is in
the income statement.

Conversely, the distinction does not seem important when
recognition is in a separate statement of movements in equity

# HIGHLIGHTS ANALYTICAL STUDIES

Most studies models recognition and measurement of financial instruments under the lense of what provides **more or less information**
– equivalent to studying mandated disclosures

A number of studies concentrates on the effects on compensation/distributions

Does fair value accounting provide useful information for economic decision making?

**Mixed results**

The intuition that **more information is always better** is **not true**
– the research unravels conditions under which it is not true

# FINANCIAL INSTRUMENTS - IN SUM

- We need more **current** evidence
- We need more evidence from **Europe**
- We need more evidence from **outside the banking industry**
- We need more evidence from **non-investors**

**Topics (not exhaustive):**

1) fair value accounting (the long term goal?)
2) hedging
3) volatility/prediction
4) items bypassing the income statement
5) should management's intent influence the accounting
6) earnings management and financial instruments
7) note disclosure vs. recognition (one suggestion is to eliminate all hedge accounting with disclosure of hedging activities)