
Conjectures Regarding the Adoption of Fair Value Measurements in Brazil

Conjecturas Acerca da Adoção da Mensuração a Valor Justo no Brasil

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Abstract

The issue of relevance versus reliability has always been a debate in accounting. Far from being a consensus among the community, the adoption of fair value measurements is intended to present a more realistic view of an entity's financial position. However, it could also cause a loss of credibility due to the subjectivity inherent in the valuation process. Wishing to make a contribution to the existing literature on this issue, this paper presents a discussion about the adoption of fair value measurements in Brazil. First, we present a brief examination of asset and liability valuation using the accounting theory as a framework. Following, we conduct a review of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) standards regarding fair value measurements. Empirical studies addressing fair value are also reviewed. Finally, a discussion about its implementation is presented, aiming to take into account the specificities of the Brazilian Market. This paper intends to contribute to the construction of academic knowledge in accounting by debating an issue which is a real problem for organizations, and yet incipient in the national literature.

Key words: Fair Value, Valuation, Accounting Standards, Brazil.

Resumo

A discussão acerca da relevância versus confiabilidade da informação é um dos assuntos mais debatidos na contabilidade. Longe de ser consenso entre a comunidade contábil, a mensuração a valor justo objetiva fornecer uma visão mais realista da situação econômico-financeira de uma entidade. Contudo, também poderia resultar na perda da credibilidade da informação contábil em razão da subjetividade existente no processo de avaliação dos ativos e passivos. Com o objetivo de apresentar uma contribuição à literatura existente acerca desse debate, o presente trabalho apresenta uma discussão sobre a adoção da mensuração a valor justo no Brasil. Primeiramente, apresenta-se uma breve revisão da avaliação de ativos e passivos de acordo com a teoria contábil. Em seguida, examinam-se as normas do *International Accounting Standards Board (IASB)* e do *Financial Accounting Standards Board (FASB)*. Analisam-se também algumas pesquisas empíricas acerca da mensuração a valor justo. Finalmente, busca-se analisar alguns aspectos específicos da implementação dessa norma contábil no Brasil. De uma maneira geral, o trabalho busca contribuir para a construção do conhecimento científico em contabilidade, na medida em que discute um tema que é um problema real das organizações e, todavia, incipiente na literatura brasileira.

Palavras-chave: Valor Justo, Avaliação, Normas Contábeis, Brasil.

1 Introduction

The debate on fair value measurements, yet incipient in Brazil, is one of the most addressed issues in the international community (BARTH, 1994; BARTH and LANDSMAN, 1995; NELSON, 1996; ABOODY, BARTH, and RASZNIK, 2004; etc.). Researches from different parts of the World and standard setters like the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been discussing issues regarding the adoption of fair value in valuing assets and liabilities for a long time.

However, this debate is far from reaching a consensus. As stated in the FASB's website, "in many accounting pronouncements the Board has concluded that fair value information is relevant and users of financial statements generally have agreed. Others, however, have expressed concerns about the ability to apply the fair value measurement objective in GAAP" (FASB, 2007).

Despite this debate, FASB issued SFAS No. 157 "Fair Value Measurements" in September of 2006, which should be utilized with the other standards addressing fair value as from September of 2007. According to the FASB, SFAS No. 157 "defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements".

At the same time, the IASB has also opted to utilize SFAS No. 157 as a starting point to develop a standard on fair value measurements. This decision takes into consideration the Norwalk Agreement, in which both entities have stipulated the convergence process.

In November of 2006, the IASB also published a Discussion Paper on Fair Value Measurements. Following, taking into consideration criticisms and suggestions from the accounting community, IASB started to elaborate an Exposure Draft, which should be finished and published in 2009, according to the entity's schedule.

It is worthwhile to mention that the discussion about the adoption of fair value measurements also impacts the Brazilian market. As the process of convergence arises, the Brazilian Generally Accepted Accounting Principles (BRGAAP) tends to be replaced by the International Financial Report Standards (IFRS). That being said, the adoption of fair value measurements seems just a question of time.

In this sense, wishing to make a contribution to the existing literature on this issue, this paper presents a discussion about the adoption of fair value measurements in Brazil. The remainder of this paper is organized as follows. Section 2 presents a brief examination of asset and liability valuation using the accounting theory as a framework. Section 3 reviews IASB's and FASB's standards regarding fair value measurements. Section 4 presents some empirical studies on the topic, and section 5 discusses its implementation considering the specificities of the Brazilian market. Finally, section 6 brings the conclusions and recommendations for future studies.

2 Measuring Assets and Liabilities

What is accounting? It is amazing how this simple, basic question has never been answered precisely (KAM, 1986). A widely-held concept of accounting considers it the process of identifying, measuring, recording, and communicating economic information about an organization. According to Hendriksen and Van Breda (1999), accounting places emphasis on the quantification of economic relationships and economic changes in terms of a monetary unit.

The accounting theory lists several methodologies that can be utilized to measure an asset or a liability. In fact, different methodologies may result in different pictures of an organization's financial position. This leads us back to an everlasting debate in accounting: relevance versus objectivity. Obviously, we would prefer the more relevant information from a set of equally objective values. Also, we would prefer the more objective information from a set of equally relevant values. However, in most cases, there is a trade off between objectivity and relevance. This raises the following question:

Would we rather have a methodology that better reflects the economic value of an asset (liability) or do we prefer to lose some relevance but gain some objectivity?

In the next sub-sections, we present a discussion of the different methods used for valuing assets and liabilities.

2.1 Entry Values

Iudícibus (1999) states that input values are considered adequate for valuing assets and liabilities due to the fact that in many cases there is not a market in order to determine an exit price. According to this author, entry values are also more reliable and prevent revenues from being recognized before realization. Some examples of entry values are:

> **Historical Costs.** Comprise the value of exchange in the moment an asset is acquired or a liability is contracted. According to Martins (2000), the fundamental underpinning for the adoption of historical costs is its link with cash flow from past transactions. The main advantage of historical costs is its simplicity and objectivity. However, in subsequent periods, past costs lose relevance for the decision making process of external users of financial statements.

> **Current Costs.** Represent the price that would be paid in order to acquire a similar asset or contract a similar liability. In this sense, the current costs are stipulated by the market. However, despite this fact, it is still an entry price, as it represents the price that would be paid to replace the asset (liability).

> **Adjusted Current Costs.** Comprise the current costs adjusted by the inflation for the period. In this sense, a current cost in t_0 could be compared to a current cost in t_1 , revealing the inflation between periods.

2.2 Exit Values

Exit values, also called output values, are based on the amount of cash or the value of other considerations to be received when an asset or its service finally leaves the firm by an exchange conversion (HENDRIKSEN and VAN BREDA, 1999). Some examples of exit values are:

- > **Discounted Future Cash Flows.** Involve basically two variables: an estimation of future cash flow and interest rate in order to discount the expected receipts. Entity's cost of capital or the risk-free rates of return (T-Bonds, savings, etc.) are some examples of interest rates used for cash flow discounting.
- > **Current Exit Prices.** Represent the current price at which an asset can be sold. According to Hendriksen and Van Breda (1999) when the product of an organization is sold in an organized market, the current price may be a reasonable estimate of the actual selling price in the near future.
- > **Current Cash Equivalents.** Represent the amount of cash that could be obtained by selling each asset under conditions of orderly liquidation. However, it does not take into consideration the fact that some assets might not have an active market.
- > **Liquidation Values.** The liquidation value is quite similar to the current cash equivalents concept, except that they are obtained from different market conditions. Liquidation values assume the discontinuation of business operation; therefore, market price may be actually different from the previous condition.

As evidenced above, accounting theory presents different methodologies in order to measure assets and liabilities. As expected, each method presents advantages and disadvantages. The conceptual framework of accounting still relies on the historical cost for measuring most assets and liabilities, with few exceptions, for instance, SFAS 133 - Accounting for Derivative Instruments and Hedging Activities, which requires financial instruments to utilize fair value measurements. However, many have argued that the use of historical costs contradicts the main purpose of financial statement, as stated by FASB Statement No. 1 (1978):

“Financial reporting should provide information that is useful to present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts”.

In this sense, it is argued that fair value measurements will be more relevant than historical costs to users of financial statements interested in accessing the value of the firm. According to Iudícibus and Martins (2006) if the fair value application becomes generalized in financial statements, it will represent a true revolution in financial reporting.

However, paragraph 41 of SFAC No.1 (1978) also states that “information provided by financial reports may help those who desire to estimate the value of a business enterprise, but financial accounting is not desired to measure directly the value of an enterprise”.

Although fair value measurement may be beneficial to those interested in valuing the firm, other users such as creditors, customers, and employees may have other demands. In this sense, Holthausen and Watts (2001) state that the FASB also includes among its definition other users of accounting information who are not primarily interested in equity valuation. According to these authors, non-valuation factors, specially contracting and regulation are central to accounting practice.

On the other hand, Barth, Beaver and Landsman (2001) state that the primary focuses of the FASB and other standard setters is equity investment. In their view, other users of accounting information are important, but investors are the main users of financial reports.

As stated in the above paragraphs, the debate regarding the adoption of fair value measurements is far from reaching a consensus among the accounting community. In the next section, we examine fair value by reviewing its concepts, discussing the FASB and IASB standards and reporting the results of some empirical studies.

3 Fair Value Measurements

In this topic, we present a brief discussion of fair value, bringing the view of standard setters and researchers.

3.1 Definition of Fair Value

SFAS No. 157 defines 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” (SFAS No. 157, § 5).

The main shift brought by SFAS No. 157 was the use of an exit price in order to estimate the fair value. Before that, entry prices were used in some cases, while in others, there was some doubt about which one to use. On the other hand, the International Accounting Standards Board (IASB), in its Discussion Paper entitled “Fair Value Measurements” (2007: 8), defines fair value as “the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”. According to this discussion paper (p. 8), the definition in SFAS 157 differs from the definition in IFRSs in three important ways:

- > “The definition in SFAS 157 is explicitly an exit (selling) price. The definition in IFRSs is neither explicitly an exit price nor an entry (buying) price.
- > The definition in SFAS 157 explicitly refers to market participants. The definition in IFRSs refers to knowledgeable, willing parties in an arm’s length transaction.
- > For liabilities, the definition of fair value in SFAS 157 rests on the notion that the liability is transferred (the liability to the counterparty continues; it is not settled

with the counterparty). The definition in IFRSs refers to the amount at which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.”

The first question to be answered is: What is the most appropriate definition of fair value? Exit values, considering the market perspective?

Barth and Landsman (1995) state that the debate on exit value, entry value, and value-in-use has a long history in the accounting literature. According to Beaver and Demski (1979) these values are different due to the inexistence of complete and perfect markets. Thus, different dates might result in different values. For instance, in the acquisition date, value-in-use will be an entry price. But after a certain period, value-in-use might be either higher or lower, which in some cases will result in asset reevaluation or impairment.

At the same time, the value-in-use of an asset will be different for each firm. According to the FASB's definition of fair value, the difference between value-in-use and exit values is the value of managerial capacity. Obviously, if an asset has a higher value-in-use than an exit value, management is adding some value to it. For Barth and Landsman (1995), value-in-use is the only one that captures the value of the asset associated with the firm; therefore, it should be the one considered for fair value measurements.

3.1.1 Value-In-Use versus Value-in-Exchange

Paragraph 12 of SFAS No.157 (p. 21) states that “a fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date.” The highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different. In this sense, the standard (p. 21) defines:

> **Value-In-Use.** “The highest and best use of the asset is in-use if the asset would provide maximum value to market participants, principally through its use in combination with other assets as a group (as installed or otherwise configured for use).”

> **Value-In-Exchange.** “The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis.”

On the other hand, the International Accounting Standard Board (IASB) mentions only the value-in-use when estimating the fair value for assets and liabilities.

3.2 Market Participants

SFAS No. 157 (p. 11) specifies that fair value is a market-based measurement, not an entity-specific measurement. The definition also establishes some characteristics of market:

- > “Independent of the reporting entity; that is, they are not related parties
- > Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
- > Able to transact for the asset or liability
- > Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.”

On the other hand, the definition of fair value in IFRSs refers to

‘knowledgeable’, willing parties in an arm’s length transaction’. In this context, ‘knowledgeable’ means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and market conditions at the balance sheet date. The IASB also stresses that a willing buyer is motivated, but not compelled, to buy. This buyer is neither over-eager nor determined to buy at any price. The assumed buyer would not pay a higher price than a market comprising knowledgeable, willing buyers and sellers would require. (DP, p. 12)

A point that raises questions is related to the inexistence of an active market for assets and liabilities in less developed countries like Brazil. However, the FASB suggests that:

The Board agreed that it would be reasonable to presume that a market participant that is both able and willing to transact for the asset or liability would undertake efforts necessary to become sufficiently knowledgeable about the asset or liability based on available information, including information obtained through usual and customary due diligence efforts, and would factor any related risk into the fair value measurement. (SFAS No. 157, Appendix C, § C34).

3.2.1 Principal Market (or Most Advantageous) Market Participants

According to the finance theory, the objective of the firm is to maximize shareholders wealth. In this sense, the FASB assumes that both buyers and seller are rational and look to maximize profits. Thus, SFAS No. 157 defines the most advantageous market as “the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective markets”. (DP. P. 17)

On the other hand, the IASB does not mention which market to consider when using fair value measurements. In its Discussion paper, the international board seems to agree with the definition stated by the North-American Board.

3.3 Fair Value Hierarchy

SFAS No.157 classifies the inputs to be considered in the estimation in: observable and non-observable. Observable inputs are obtained from the market and refer to the premises assumed by the participants. On the other hand, non-observable inputs are those assumed by the reporting entity and refer to the premises that would be assumed by market participants. The North-American Board states that entities should prioritize observable inputs and disclose the assumed premises in order to guarantee consistency and comparability. In order for that to happen, SFAS No.157 also establishes a hierarchy for data input, which is divided in 3 levels:

- > **“Level 1.** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- > **Level 2.** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.
- > **Level 3.** Inputs are unobservable for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that 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. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability.”

The Discussion Paper from the IASB does not define a hierarchy like SFAS No.157. However, it does mention that a hierarchy is needed, and for this reason the IASB accepts the hierarchy established by the FASB.

In the process of estimating the fair value for assets, valuation techniques can also be used. SFAS No.157 lists a few techniques, as exemplified below:

- > **Market approach.** It is “applied using quoted prices for similar assets adjusted for differences between the asset (as customized) and the similar assets. The measurement reflects the price that would be received for the asset in its current condition (used) and location (installed and configured for use), thereby including installation and transportation costs.” (p. 23)

> **Cost Approach.** It “is applied by estimating the amount that currently would be required to construct an asset (customized) of comparable utility. The estimate considers the condition of the asset (for example, physical deterioration, functional obsolescence, and economic obsolescence) and includes installation costs.” (p. 23)

> **Income approach.** It “is applied using a present value technique. The cash flows used in that technique reflect the income stream expected to result from the (...) asset (...) over its economic life.” (p. 24)

As described above, valuation techniques have an inherent subjectivity that involves choosing the effective interest rate and the valuation model. This arbitrariness may hinder one of the qualitative characteristics of accounting information: the verifiability of the accounting information. SFAC No.2 (1980) defines verifiability as “the ability through consensus among measures to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias.”

In this sense, the subjectivity inherent in fair value measurements may result in a loss of verifiability. Also, due to the fact that top management is often evaluated and compensated on the basis of earnings and stock prices, fair value measurement might open possibilities for earnings management.

3.3.1 Large Quantities of a Single Asset

It is worthwhile to mention that in some cases, entities may have large quantities of a single asset. This raises questions regarding the differences between the price for a single asset and the price for large quantities of that same asset. Regarding this issue, neither the FASB’s nor the IASB’s standards allow discounts for liquidity purposes whenever an entity holds large quantities of a single asset. SFAS No.157 only allows liquidity discount in the cases of inexistence of an active market for the asset.

3.4 Fair Value at Initial Recognition

At first, the best evidence of the fair value at the initial recognition is the transaction value. However, SFAS No. 157 states that entry and exit price are conceptually different. FASB understands that it is possible to have a gain or loss resulted from the difference between the fair value and the amount actually transacted. In certain situations, when there is no active market for an asset or liability, a valuation technique is used, and gains or losses are recognized. This is consistent with the view of the Board that fair value is an exit price, not an entry price.

As mentioned above, fair value might differ from the entry price. That might occur due to some specificity related to the entry transaction (FASB, p. 6), such as:

> **Related parties.** “The transaction is between related parties.”

- > **Forced transaction.** “The transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty or discontinuation.”
- > **Different unit of account.** “The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value.”
- > **Different market.** “The market in which the transaction occurs is different from the market in which the reporting entity would sell the asset or transfer the liability, that is, the principal or most advantageous market.”

3.5 Fair Value for Liabilities

Paragraph 15 of SFAS 157 (p. 6) states that “a fair value measurement assumes that the liability is transferred to a market participant at the measurement date (the liability to the counterparty continues; it is not settled) and that the nonperformance risk relating to that liability is the same before and after its transfer. Nonperformance risk refers to the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred.”

The standard also requires the entity to consider the credit risk when estimating the fair value for a liability. On the other hand, the IASB also makes reference to the credit quality of the instrument. However, the Discussion Paper on Fair Value Measurements states that both concepts (entity credit risk and instrument credit risk) are consistent.

According to Barth and Landsman (1995), although estimating fair value for assets and liabilities is conceptually similar, liability valuation might be a problem for entities facing financial condition deterioration. An alternative form, usually used for financial institutions in valuing financial instruments, that is to estimate the value that could be hedged.

3.6 Requirements for Disclosure

According to the SFAS No.157 (p. 12), the requirements for disclosure differ, depending on how often the fair value measurement is applied. For assets measured in a recurring basis, the following requirements should be observed:

- > “The fair value measurements at the reporting date.
- > The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3).

- > For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:
- (1) Total gains or losses (...);
 - (2) Purchases, sales, issuances, and settlements (net)
 - (3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)."

3.7 Changing the Income Concept: Other Comprehensive Income

Measuring assets and liabilities at fair value also implies a discussion on how the variations arising from the application of this concept will be recognized. According to Iudícibus and Martins (2007), the revenue principle implies 4 requirements for recognition:

- I. An objectively defined price
- II. The complete development of all phases necessary to obtain the revenue merit
- III. Cash or the assurance of future receipt
- IV. Knowledge of all the expenses involved in that revenue.

One might note that measuring fair value measurements does not always meet the above criteria, as the recognition of gains and losses occurs before the revenue realization. Regarding this issue, Coelho and Carvalho (2007) state that "the generating factor of economic events are the changes in assets and liabilities. Therefore, all changes in those items derived from either the company's operation or from other outside events will generate revenues and expenses, leading to a change in the entity value".

This discussion leads to a broader issue related to the concept of comprehensive income, a mechanism created in order to enable the recognition of economic changes of certain assets and liabilities not yet considered in the company's profits. According to Iudícibus and Martins (2007), comprehensive income enables assets and liabilities measured at fair value to be classified into a group of the company's equity until they are transferred to the company's profit after realization.

4 Empirical Studies Addressing Fair Value

The literature review has highlighted that the fair value theme is yet incipient in the Brazilian context. A survey conducted in the main accounting journals and forums indicated the existence of only three papers addressing fair value in Brazil.

Lisboa, Pigatto and Costa (2000) discussed issues related to the concept of fair value, especially in the measurement of financial instruments. Iudícibus and Martins (2007) critically examined the accounting standards and suggested a few

changes in order to make fair value measurements more objective. Trombetta et al. (2007) examined disclosure regarding fair value measurements for financial instruments from a sample of financial institutions.

Contrary to the Brazilian scenario, fair value measurements have been widely researched by the international community. Most authors have conducted value relevance studies. These studies are used to determine whether an accounting number is useful for valuing the firm by investigating if the number is associated with stock prices (HOLTHAUSEN and WATTS, 2001).

Barth (1994: 1) investigated “how disclosed fair value estimates of banks’ investment securities and securities gains and losses based on those estimates are reflected in share prices in comparison with historical costs.” The author concluded that fair value estimates of investment securities are more effective in providing significant explanatory power than historical costs.

Nelson (1996) evaluated the association between the market value of banks’ common equity and fair value estimates disclosed under Statement of Financial Accounting Standards No. 107, “Disclosures about Fair Value of Financial Instruments.” “The results suggest that only the reported fair values of investment securities have incremental explanatory power relative to book value. No reliable evidence of incremental explanatory power is found for the value disclosures of loans, deposits, long-term debt or net off-balance sheet financial instruments.” (NELSON, 1996: 161)

Aboody, Barth and Rasznik (2004: 251) examined “the relation between share price and stock-based compensation expense that is disclosed but not recognized under SFAS No. 123. Findings based on annual returns indicate that SFAS No. 123 expense reflects on a timely basis changes in investor-perceived costs associated with stock-based compensation.

Other studies on fair value measurements have tried to identify the perception of accounting users. PricewaterhouseCoopers (2007a) examined the perception of 50 equity investors from Boston, London and New York. The findings demonstrate that investors are concerned with the organization’s operational performance and that they disapprove of measuring operational assets using fair value. PricewaterhouseCoopers (2007b) conducted a study with 78 senior financial managers from FTSE350 companies. Results indicate that 74% of the respondents are against the implementation of fair value measurements.

5 Implementation of Fair Value Measurements in Brazil

It seems reasonable to think that standard setters are influenced by the bargain power of organizations and countries. In this sense, one should not expect the International Accounting Standards Board (IASB) to take into consideration the

Brazilian market specificities when elaborating an accounting standard. Obviously, countries like the United States, England, Australia, Germany, among others, have a much larger influence due to the relevance of their economy and stock market.

Therefore, in this section we present a few specificities of the Brazilian market that we believe should be taken into consideration when adopting a standard requiring fair value measurements. Thus, we briefly discuss three aspects related to the Brazilian market: lack of enforcement, code law system and the tax influence of financial reporting.

5.1 Lack of Enforcement by the Comissão de Valores Mobiliários (CVM)

Normative accounting bodies state how financial reporting should be. However, as one might suspect, there are differences between “what it ought to be” and “what it actually is”. In general, empirical studies have revealed that Brazilian corporations do not always do what they should. For instance, the work of Murcia, Borba and Amaral (2005) has demonstrated that the *Comissão de Valores Mobiliários (CVM)* fails to enforce the requirement for financial report restatement.

This lack of enforcement might also be a problem when corporations do not do what the standard requires. The work of Trombetta et al (2007), which analyzed disclosure regarding fair value measurements for financial instruments for a sample of Brazilian banks, showed that companies utilized different methods and the quality of disclosure varied among firms. According to the authors, results suggest that there is omission of relevant information which may actually harm financial report users.

In this sense, the adoption of fair value measurements may cause an adverse result if corporations do not explicitly follow the standards due to a lack of enforcement by the CVM. As mentioned throughout the text, fair value measurements are complex; therefore, for this information to be relevant for the decision making process of financial statement users, full disclosure is needed.

5.2 Tax Influence

Due to the fact that there is no demand for informative accounting reports, since firms do not rely on external sources of finance and banks supply finance privately, financial reports in Brazil are prepared to comply with tax and government regulations (LOPES and GALDI, 2008). In this same line of thinking, Iudícibus, Martins and Carvalho (2005) state that the accounting treatment on leasing, non-deductible provisions and donations are some examples of the tax influence on the financial statement reporting.

In Brazil, the predominant thought for decades has been: Why invest in preparing more accurate financial statements, if tax law always prevails

(CARVALHO, LEMES and COSTA, 2006)? According to Lopes and Galdi (2008), the Brazilian financial reporting system is a typical case of a code law emerging market stakeholder model which does not produce informative accounting reports – from an equity investor perspective.

In this scenario, fair value measurements have to be well defined and accepted; otherwise, they will only raise company's costs but will not bring any benefits to accounting users.

5.3 Code Law System

There are two basic law systems in the World: common law and code or civil law. Most of the English speaking countries such as the United States, England, Australia, and Canada adopt the common law system. On the other hand, most of the Latin-language speaking countries such as Italy, Argentina, France and Brazil adopt the code law system.

As expected, the law system does influence financial reporting. According to Welfort (2005), the fact that Brazil has a code law system may result in the following consequences for the accounting practice:

- > Low level of disclosure;
- > Difficulty in following changes stipulated by regulatory bodies like the IASB;
- > Low protection to minority stockholders;
- > Prevalence of the form over essence in measuring events.

In this sense, the implementation of fair value measurements will be a challenge. Brazilian accountants will have to learn how to deal with the essence of economic events, instead of opting for the simplicity of historical costs.

6 Conclusion

The objective of this paper was to present a discussion about the adoption of fair value measurements in Brazil. To achieve this goal, a literature review was conducted, including standards from the FASB and the IASB, as well as scientific papers. In this work, we intended to extend the work of Iudícibus and Martins (2007) by examining if the adoption of fair value measurements adds value to the accounting information. Also, we critically examined if the benefits of fair value adoption are superior to its costs.

As mentioned throughout the text, fair value measurements represent a path-breaking advance in the actual accounting conceptual framework that has for a long time been based on the historical cost premise. The literature review also showed some possible problems regarding their implementation in Brazil, specially the lack of enforcement by CVM, tax influence and the code law system.

A review of some value relevance studies showed that fair value measurements seemed to be more relevant for equity valuation. However, two studies conducted by the auditing firm PricewaterhouseCoopers (2007a, 2007b) demonstrated that accounting users seem to be contrary to fair value measurements, especially for operational assets.

In this same line of thinking, standard setters have not conducted research with users of accounting information in Brazil yet. If financial statement reporting is to be relevant to accounting users, we do have to ask them about what kind of information they want. Otherwise, we will be doing accounting for accountants.

Finally, it is worthwhile to mention the efforts by standard setters like the FASB and the IASB in trying to develop accounting standards that better reflect the changes in the corporation's economic condition. As accounting valuation is to follow economic events, then fair value is definitely the future for asset and liability valuation. However, care is needed as the implementation of a fair value standard should consider countries' specificities. In this sense, we suggest further empirical research that can test the value relevance of fair value measurements. We recommend value relevance studies, as well as surveys, to identify users' perceptions.

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