**FAIR VALUE ACCOUNTING IN INDIAN ACCOUNTING SYSTEM**

**Dr. Vijayakumar A.B\***

**Dr. Vatsala G\*\***

***ABSTRACT***

Organisations attract investors using financial statements, which are also very critical to the (financial) accountant of the company to disseminate/disclose financial information to the stakeholders of an organisation. As the assets and liabilities recorded under the traditional accounting system do not reflect their current value, the concept of fair value accounting under the IFRS was introduced, which is aimed at making the information provided by the (financial) accountant more relevant, reliable and comparable. India being one of the fastest growing/emerging economies of the world, this study focuses on understanding the concept of fair value accounting, examines the degree of its adaptability to Indian and Global organisations and analyses the benefits of implementing it in our country.

**Key words: Fair value, Reporting, Assets, Liabilities.**

\*Associate Professor, PG Dept. of Commerce and Management, Seshadripuram First Grade College, Yelahanka new town, Bangalore.

\*\*Professor and Director,PG Dept. of Commerce and Management, Seshadripuram First Grade College, Yelahanka new town, Bangalore.

**Introduction**

Most countries across the globe are either adopting the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) or converging their own standards to the IFRS. This is expected to bring in much needed comparability and uniformity across the accounting practices. So far, there were only 32 accounting standards but after the implementation of the IFRS, another 15 are added back to AS. Fair value measurement is explained under IFRS 13.

`The birth of fair value concept in accounting theory can be traced back to the 1930’s. In the late 19th century and early 20th century, it was introduced by the German and French legislation which impacted accounting practice. Thus, FVA was common for firms to value their capital assets using evaluated values that the assets would bring in the market. Therefore, many early economists also believed that the fair value accounting, known as Mark to Market accounting, which was first used during the great Depression, but it was suspended in the year 1938 by President Franklin D. Roosevelt. However, during the 1930’s abusive valuation practices made by various mangers led to the enactment of more formal accounting standards by the accounting profession. As a result, historical cost accounting emerged as the dominant practice for reporting most assets and liabilities. Additionally lack of transparency under historical cost accounting could make matters worse during crises. It is generally accepted that FVA is more appropriate than Historical Cost Accounting when the markets in which the assets are traded are highly liquid. However, Historical Cost Accounting does not reflect the current fundamental value of an asset either. Therefore, it might be better to use market values, even if the markets are illiquid and to supplement them with additional disclosure. Now India is one of the 14 countries which have adopted the IFRS for at least. Hence, India has finally adopted fair value measurement in its business reporting system. For the purpose of defining and measuring fair value in India, the ICAI has introduced converged Indian accounting standards in line with IFRS.

**Review of Literature**

**Phani (2015)** concludes that sincethe assets and liabilities recorded under traditional accounting system do not reflect their current value, the concept of fair value was introduced under the IFRS to make the information provided by the financial accountant more relevant, reliable and comparable.

**R et.al, (2016) attempt** to answer the oft-repeated crucial questions, what are the fair values of assets and liabilities so that financial projections could be based on realistic assumptions? This question in fact subsumes yet another question, namely: what methods of valuation of assets and liabilities are to be adopted which would help the informed investor to take matured decision.

**Debarshi and Bhattacharya (2017)** in their article have examined about the Adoption of Fair value accounting in Indian Accounting System. The study is totally focused on the degree of adoption of Fair value accounting in Indian Accounting system

**Najeb Masoub and Abdullah Daas (2014)** Explore the role of FVA in the Global Financial Crisis. The study focuses on the global financial crisis which started in advanced economies and spread to emerging markets and low income countries. This paper uses the value of relevance of fair – value reported under FAS 157 that estimates assets and liabilities.

**Bin (2013)** has examined the Mandatory IFRS Adoption and Accounting Conservatism. The study is mainly focused on the effect of adoption of IFRS in Indian Accounting System and also provided suitable solution to the problem

**Objectives of the Study.**

The major objectives of the present study are as follows:

* To understand the concept and measurement techniques of fair value accounting.
* To understand the IFRS conceptual framework on fair value Measurement of Assets and Liabilities
* To examine the degree of adoption of fair value in Indian and global Scenario.
* To analyse the benefits of fair value accounting in Indian accounting system.

**Concepts of Fair value**

On 1st of January 2012, the IASB introduced IFRS 13 on ‘Fair Value Measurement’ which defines fair value, which set out in one IFRS framework for measuring fair value and also required to disclose the fair value measurements. Fair Value means It is the price that would be received to sell an asset or paid to transfer a liability in an ordinarily transactions between market participants at the measurement date. Some features of fair value are

* The fair value is a current exit price on the measurement date.
* The fair value is a market based measurement but not an organization specific measurement.
* The fair value is determined in the principal market where orderly transactions take place for assets or liability.
* The Fair value establish as the consistency and comparability in fair value measurement

Fair – value Accounting is defined in IAS 39 as the price at which an asset could be exchanged in a current transaction between knowledgeable and willing parties often is also called Mark – to Market accounting which is the practice of banks and other financial institutions updating the valuation of assets or securities on a regular basis. For liabilities, FVA is defined as the amount that would be paid to transfer the liability to a new debtor.

**Major Benefits of Fair Value Accounting**

* It is very beneficial to the companies to report the amount of assets and liabilities more accurately, timely and comparable than the amounts that would be reported under the traditional accounting syst
* It’s very helpful to report updated market value of assets and liabilities on a regular basis.
* It limits company’s ability to manipulate their net income.
* Gains and losses resulting from changes in fair value estimate indicated economic events that companies and investors may find worthy of additional disclosures.
* It is very helpful for the overall growth of the organization and avoids confusions in maintaining books of accounts.

**Fair Value Hierarchy for Determining Assets and Liabilities**

For the Consistency and Comparability Fair value Measurement under Indian AS 113 establishes a fair value hierarchy for determining Assets and Liabilities that consists of three levels of inputs to the valuation techniques of measurement of fair value as suggested by the standard. These are

1. **Level 1 Inputs**
2. **Level 2 Inputs**
3. **Level 3 Inputs**
4. **Level 1 Inputs :**

It is defined as “The price quoted in active markets for identical assets and liabilities that the entity can access at the measurement date”. The level 1 input represent the quoted unadjusted prices of the identical assets in the market.

1. **Level 2 Inputs:**

“Level 2 inputs are inputs other than quoted market prices which include within Level 1 that is observable for the asset or liability, either directly or indirectly.” The Level 2 inputs explain prices which are quoted for the similar assets and liabilities in the active market.

1. **Level 3 Inputs :**

Level 3 Inputs are defined as “unobservable inputs for the assets or liability.” The Level 3 inputs are unobservable inputs used in the situation in which there is no information on market activity of assets or liabilities. In the process of determining the fair value of assets and liabilities, the organization should follow the fair value hierarchy which indicates that preference should be given to Level 1 inputs and in its absence the company should use level 2 and level 3 inputs.

It indicates that the fair value hierarchy gives the highest priority to level 1 inputs and the lowest priority to the level 3

**Valuation Techniques**

According to the Indian AS 113, an entity should use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

The main objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the assets or to transfer the liability would take place between market participants and the measurement date under current market conditions

There are three valuation Techniques which are as follows.

* Market Approach
* Cost Approach
* Income Approach

**Market Approach:**

It is refers to the fair value of assets and liabilities which is arrived based on the price or other relevant information generated by the market transactions involving assets and liabilities.

**Cost Approach:**

It refers to the fact that replacement cost is considered as the fair value of the assets and liabilities.

**Income Approach**

Under this approach the fair value is the discounted value of the future amount (i.e., cash flows or income and expenses associated with the assets. In some cases, a single valuation technique may be appropriate, whereas in others, multiple valuation techniques may be better.

**Adoption of Fair Value Accounting in Indian Scenario**

Time has really come to examine the degree of adoption of Fair Value concept in Indian Financial Reporting System as part of the convergence with the International Financial Reporting Standard (IFRS). From the recent past, the companies registered in India prepared their financial statements on the basis of Rules and regulations prescribed by the Ministry of Corporate Affairs (MCA), Government of India, and Accounting Standards as issued by the Institute of Charted Accountants of India (ICAI). These standards were prepared on the basis of the existing accounting practices in India and world.

The standard setters, while preparing these standards, took into consideration globally existing best practices and Indian social, economic, financial and political conditions. Still these standards were not fully convergent with the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) which were subsequently adopted by a large number of countries across the globe. In India, a number of Asses had already been issued by the ICAI that require assets and liabilities to be measured at fair value. Some of the standards define fair value, while in some others, it has been referenced. These ASs are : AS – 26 on Intangible Assets, AS – 28 on Impairment of Assets, AS – 30 on Financial Statement Instruments, Recognition and Measurement, AS – 31 on Financial Instruments Presentation and AS – 32 on Financial Instruments: Disclosures. The ICAI decided that the converged IFRS should be followed in India too for public interest entities from the accounting period starting on or after April 1, 2011. In this context, the ICAI Published a concept paper on converged IFRS in India. This paper provided the road map to adopt the IFRS in India by 2011. To ensure a fully converged set of standard, the MCA prepared a road map in 2010 in which it was decided that there would be two sets of Corporate Financial Reporting Standards U/S 211(3C) of the companies Act 1956 for achieving convergence with IFRS.

There were a) Which will be converged Indian Accounting Standards in the line of IFRS and will be adopted by the specified class of companies in a phased manner and b) Which are existing Indian Accounting standards and would be applicable to other companies, including Small and Medium Companies. In the said road map it was decided the first set of ASs will be applied to specified class of companies in the following phase.

**Voluntary Adoption**

Companies can voluntarily adopt In AS for accounting periods beginning on or after 1st April 2015 with comparatives for the period ending 31st March 2015 or thereafter. However, once they have chosen this path, they cannot go back.

**Mandatory Adoptions**

**Phase I**

Indian Accounting Standard will be applicable to the following companies for the periods beginning on or after 1st April 2016, with comparatives for the period ending 31st March 2016 or thereafter.

* Companies whose equity and debt securities are listed or more in the process of listing on any stock exchange in India or outside India and having net worth of 500 core INR or more.
* Companies having total net worth of 500 cores INR or more than those covered above.
* Holding, Subsidiary, joint venture or associate companies covered above.

**Phase II**

Ind AS will be mandatorily applicable to the following companies for periods beginning on or after 1st April 2017, with comparatives for the period ending 31st March 2017 or thereafter.

* Companies whose equity and debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees 500 crores INR.
* Unlisted companies other than those covered in phase I and phase II whose net worth are more than 250 crores INR but less than 500 crores INR.
* Holding, Subsidiary, Joint venture or associate companies of above companies.



**Exemptions**

According to Sub – Rule (1) of Rule 4 of MCA, The Insurance Companies, banking Companies and non – banking finance companies shall not be required to apply IND AS for preparation of their financial statements either voluntarily or mandatorily.

The MCA issued a road map for implementation of the Indian Accounting Standards Converged with the IFRS for banking companies, insurance companies and Non- Banking Financial Companies (NBFCs) in a phased manner commencing from accounting periods beginning on or after April 1, 2018 by its notification dated 30th March 2016. MCA has issued notification dated 16th Feb 2015 in respect of phase – wise road map for adoption and applicability of companies Rules, 2015 other than banking companies, insurance companies and other NBFCs

 Further, MCA has issued a press release dated 18th Jan 2016, in which Banking Companies, Insurance Companies and NBFCs are also included.

**Adoption of Fair Value Accounting in Global Scenario**

India is one of the 14 countries that have adopted IFRS for at least some domestic publicly accountable entities. Hence, India has finally adopted fair value accounting system in their Accounting Standards. For the purpose of defining, measuring fair value in India. IFRS includes Fair Value which is not a new concept, but adaptation of fair value in accounting system is a new concept. Fair value accounting already used in most part of the world, including the European Union, Russia, Australia,, Hong Kong, Malaysia, Singapore, Chile, South Africa etc. out of the 140 countries worldwide 116 countries have already adopted IFRS for all or most domestic publicly accountable entities. 14 Countries have already adopted IFRS for the domestic publicly accountable entities and 10 countries neither require nor permit IFRS for any domestic publicly accountable entities as on date. Out of these 10 countries, One (Thailand) is the process of adopting IFRS in full and another country, Indonesia, is in the process of converting its national standards substantially with IFRS. The remaining Eight that use National or Regional standards are: Bolivia, China, Egypt, Guinea Bissau, Macao, Niger, the United States and Vietnam. The 116 Jurisdictions that require IFRS for all or most domestic publicly accountable entities include seven that have no stock exchange but that require IFRS for all financial institutions the countries are Afghanistan, Angola, Belize, Brunei, Kosovo, Lesotho and Yemen. Although a large number of countries consider IFRS favourably, it is not necessarily the case in USA.

**Corporate valuation – Benefits of Fair Value Accounting**

It is one of the processes of estimating the fair market value of a company. One of the approaches adopted by many companies for corporate valuation is Adjusted Book Value Approach. Under this approach, the company gets value by using the information provided in the balance sheet either by using investor’s claims approach or Asset - Liability approach. The value of the company can be arrived by using the following formula.

**Values of the Firm = Total Assets – Current Liabilities and provisions**

**Value of the firm = Book Value of Investor Claims.**

The Major limitation of the Adjusted Book Value Approach is that

* The Value arrived does not reflect the current value of the company
* The valuation is done based on the value of the assets and liabilities recorded Historical costs in the balance sheet.

This limitation can be eliminated if the organization adopts the concept of fair value in the valuation of assets and liabilities.

**Conclusion**

The fair value accounting also known as mark – to market accounting is often criticized for contributing to excess leverage in boom period and leading to excessive write down in recession. Some financial analysts also criticize the fair value accounting as one of the major causes of the financial crises. In spite of these criticisms implementation of the Fair value Accounting will bring uniformity and accuracy in the financial statements provided by the companies and these also help the investors and also the companies to compare one’s performance with their competitors. Hence implementation of Fair value accounting is always beneficial to the organization.

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