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Applying and Teaching Fair Valuation Accounting in Banks with a Systematic Approach

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ABSTRACT

Purpose: In this context, the current research has sought to identify the state of application and training of fair valuation accounting in banks with a qualitative approach. In this perspective, the impact of fair value accounting on the efficiency of banks is useful in making policy decisions in order to maintain the stability of the financial system through healthy banks.

Method: Using a systematic review approach, the researcher analyzed the results and findings of previous researchers and identified the effective factors. 39 articles were selected in reliable databases.

Findings: The identified categories are: the main criteria are flexibility, supervision, rules and regulations, organizational conditions, knowledge and training, government factors, needs assessment, economic growth and performance transparency; Therefore, by combining these 9 criteria, all of which have certain sources and repetitions, it is possible to identify these conditions, therefore, to study how to implement fair value accounting methods on the efficiency of banks in different stages of the business cycle or economic conditions for policy makers to understand the health of banks as well as stability.

Conclusion: The financial system is essential. If fair value accounting practices improve banks' efficiency relative to historical cost principles, the additional improvement created by using unrealized gains can be used to generate higher returns on banks' credit portfolios. Credit growth depends on the capital level of each bank. **©authors**

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Introduction

Fair value accounting measures the actual or estimated value of an asset (Dong, 2014). Current accounting rules for banks in the EU distinguish between financial instruments held for trading purposes (in the trading book) and instruments that are held to maturity (in the banking book). The instruments kept in the trading book are evaluated at the market price (Fortuna et al., 2020).

The profit and/or loss resulting from the revaluation of trading book instruments is recognized in the profit and loss account. The accounting rules of trading offices thus consider all market risks (namely price risk, interest rate risk, foreign exchange risk and liquidity risk). In contrast, bank book instruments are recorded in the balance sheet at the lower of historical cost and market value. While the loss of a bank book instrument is transferred to the profit and loss account, unrealized gains are not recognized and therefore can become hidden reserves on the balance sheet. Therefore, the accounting rules for bank books do not take into account market risks (except for currency risk, where the end-of-period value is usually applied to almost all balance sheet items) (Robin et al., 2018).

According to its proponents, an FVA regime may conceptually be an alternative approach to financial performance reporting to avoid some of the problems associated with current historical cost accounting (Ozili, 2021). One of its main advantages is increasing the degree of transparency of financial statements. However, this view remains speculative due to the lack of homogeneity and thus comparability in FVA methodology. In addition, the concrete application of a full FVA regime (which applies to all assets and liabilities) in the banking sector raises some serious problems and concerns (Sampaio et al., 2022).

Studies related to the performance of banks and the stability of the financial system have long been the subject of discussion in many countries in the last few decades. These discussions have provided rich insights into financial performance, efficiency and various determinants of financial performance, efficiency and stability of the financial system (Donleavy, 2019). Most of these studies are based on data prepared based on historical cost principles. The adoption of IFRS, which is based on fair values, is an emerging field that should be examined in terms of the financial performance of banks, the efficiency of banks and the stability of the financial system according to the theory of financial intermediation. In this conceptual paper, it is expected to investigate the effect of fair value accounting methods on the efficiency of banks in relation to the intermediation approach under the theory of financial intermediation (Georgiou, 2018).

Schinasi (2005) states that accounting is an important component in the infrastructure of a financial system and may affect the stability of that financial system. A bank's financial performance is usually measured using accounting ratios such as return on assets (ROA), return on equity (ROE) and net profit margin (Abbott et al., 2020). Fluctuations in these ratios over time are common due to various reasons such as competition, changes in policies and regulations, changes in the business environment, and changes in management, etc. Jayasekara et al. (2018) state that fair value accounting methods affect the financial performance of banks depending on the state of economic conditions.

FVA training may be appropriate for the trading desk of banks, which refers to the trading (buying and selling) of marketable securities and related instruments with the objective of profiting from short-term price changes. The use of fair value for these transactions is consistent with the availability of market prices and a short time horizon. However, the application of FVA in the bank book of banks, that is, for non-negotiable instruments such as loans, seems inappropriate for at least three main reasons. Therefore, this research seeks an answer to the question that the state of application and education of fair valuation accounting What is in banks?

Literature Review

Sahibgharani et al. (2022) presented a research titled investigating the relationship between asset revaluation and stock price fluctuations and analyzing the behavior of shareholders. Due to the current increase in inflation prevailing in the country and the topicality of the issue of revaluation among the people of the capital market, various companies are taking action towards it, which is one of the important topics. Also, the effect of revaluation on the price and the news that affects the company's shares, causes users, investors, creditors and shareholders to have different behaviors towards it.

Sediqi et al. (2018) presented a research entitled the effect of applying the fair value approach on the performance indicators of small and medium investment companies. The results showed that the ratio of return on assets and return on equity as performance indicators do not change significantly after the application of the international standard of financial reporting for small and medium enterprises.

Moradi et al. (2018) presented a research entitled challenges and opportunities of measuring fair values in line with the implementation of international financial reporting standards in Iran. In order to implement international financial reporting standards, in addition to paying attention to the economic environment, behavioral factors and measuring fair values, the training of accountants and auditors also seems to be vital. Also, measuring and reporting fair values increases accuracy, transparency, and comparability, and generally contributes to the usefulness of accounting information.

Dong (2014), presented a research titled research on fair value and bank accounting. Studies related to banks' accounting behavior of valuation for financial instruments and risk assessment, as well as the discretion of banks involved in the management of regulatory capital and profit are reviewed. Takas et al. (2021), presented a research entitled the effect of fair valuation on the quality of banks' profits: empirical evidence from developed and emerging European countries. The results showed that while the change of interest observed in the whole period and the size of banks significantly and negatively affects AEQ, the ratio of fair value assets has a significant positive effect. We show that the latter is valid only for developed countries. Iman et al. (2021) presented a research titled the effect of fair value accounting on the decline of bank stock prices. For fair value analysis of companies' financial information was performed using Automated Distributed Lag (ARDL) in Eviews software environment. The findings of the current research showed that fair value accounting has no significant effect on stock price reduction not only in the short term but also in the long term.

Khan (2020), research titled Does Fair Value Accounting Contribute to Systemic Risk in the Banking Industry? presented The research findings should be of interest to regulators and policymakers, as recent regulatory changes in light of the Basel III recommendations require the inclusion of unrealized gains and losses on AFS securities in the regulatory capital of banks with advanced approaches. Eric et al. (2018), presented a research entitled fair value accounting and financial stability. While valuing financial instruments according to their market value is still an accounting technique that is superior to alternatives (such as historical cost), if there are challenges in valuing an instrument, there is room to improve the measurement method and present changes in value.

Method

In terms of the fact that the present research seeks to apply and teach fair valuation accounting in banks in studies based on a meta-composite approach, in terms of the general approach, it is a qualitative study and with the library research method, with the library review technique in the field of applying fair valuation accounting in Banks have been done. The two prominent research databases are Scopus and Web of Science, and in these two databases, a special focus was placed on the following publishing databases:

Emerald insight- Springer Link- Science Direct- Taylor & Francis Online- SAGE journals- Wiley Online Library

In addition, in the field of Persian articles, the database of the Academic Jihad Scientific Information Center and the comprehensive portal of humanities were also taken into consideration.

Considering the range of researches conducted in the field of challenges and solutions of using fair valuation accounting in banks and of course the existence of diversity of opinions in the field of what it is due to the newness of this phenomenon, the period from 2000 to 2022. The scope of search in English articles includes (in title, abstract, keywords and text of documents): "Fair valuation accounting, fair valuation in banking, fair value measurement:.

Findings

Based on the specified keywords, the articles were reviewed. 570 articles were identified and finally 39 articles were selected by critical evaluation method. Selected articles were identified in Table 1. 39 articles were selected

Table 1. *Selected articles*

Year	Topic	Article code
2020	Discussion of "The effect of fair value accounting on the performance evaluation role of earnings	S01
2020	Understanding accounting discretion in China: An analysis of fair value reporting for investment property	S02
2015	On the Implications of Fair Value Based Merger Accounting	S03
2016	Impact of IFRS on Earnings Management: Comparison of Pre-Post IFRS Era in Pakistan	S04
2012	Fair value measurement in financial reporting	S05
2020	Fair value accounting and value relevance of equity book value and net income for European financial firms during the crisis	S06
2017	Identifying the technical challenges of using fair value in financial reporting in Iran: IFRS with an emphasis on requirements 13	S07
2016	Compilation of the model for the implementation of the fair values system in Iran with an emphasis on measurement	S08
2018	Challenges and opportunities of measuring fair values in line with the implementation of international financial reporting standards in Iran	S09
2022	How the 2008–2009 Financial Crisis Shaped Fair Value Accounting Literature: A Bibliometric Approach	S10
2022	Level 3 Fair Value Measurement and Systemic Risk	S11
2006	Fair value accounting for financial instruments: some implications for bank regulation	S12
2007	The Routledge Companion to Fair Value and Financial Reporting	S13
2015	The Necessity to Introduce The Accounting Rules And Fair Value in The Conceptual Framework	S14
2020	The effect of fair valuation on banks' earnings quality: empirical evidence from developed and emerging European countries	S15
2014	Market reactions to policy deliberations on fair value accounting and impairment rules during the financial crisis of 2008–2009	S16
2021	The Impact of International Financial Reporting Standards on Financial Reporting Quality: Evidence from Iraq	S17
2010	Does fair value accounting contribute to Systemic Risk in the Banking Industry	S18
2020	The impact of fair value accounting on earnings predictability: evidence from Jordan	S19
2016	An Option for Lemons? The Fair Value Option for Liabilities During the Financial Crisis	S20
2017	Fair value accounting and analyst forecast accuracy	S21
2020	The effect of fair value accounting on the performance evaluation role of earnings	S22
2008	Fair Value Accounting and Financial Stability	S23
2017	Fair value accounting and corporate cash holdings	S24
2011	Fair value accounting for liabilities: The role of disclosures in unraveling the counterintuitive income statement effect from credit risk changes	S25

2014	Fair value accounting, fragile bank balance sheets and crisis:A model	S26
2017	Fair value measurement and accounting restatements	S27
2007	Fair-value pension accounting	S28
2021	The effect of fair value accounting on the drops in stock prices of banks listed on the Tehran Stock Exchange	S29
2015	The effect of using fair value in financial reports in improving the value relevance of accounting information	S30
2015	Fair Value Accounting (FVA): An Overview of Key Issues	S31
2018	The effect of applying the fair value approach on the performance indicators of small and medium investment companies	S32
2018	Fair Value Accounting Practices and Efficiency of Banks: A Theoretical Perspective	S33
2016	The economic consequences of extending the use of fair value accounting in regulatory capital calculations: A discussion	S34
2017	The predictive ability of investment property fair value adjustments under IFRS and the role of accounting conservatism	S35
2021	Do fair value measurements affect accounting-based earnings quality? A literature review with a focus on corporate governance as moderator	S36
2015	Fair value accounting: information or confusion for financial markets?	S37
2017	The contribution of bank regulation and fair value accounting to procyclical leverage	S38
2013	Fair-Value Accounting and Balance-Sheet Myopia	S39

In this research, at first, all the factors extracted from the studies were considered as identifiers, and then, considering the meaning of each of them, the identifiers were defined in a similar sense; Then, similar concepts were classified in the explanatory categories so that the explanatory axes of the research indicators were identified in the form of main and sub-components of the research.

Table 2. *Main components and corresponding codes*

Categories	Open codes	Source
flexibility	Organizational flexibility	S18-S28-S33-S49
	Revision of banking structure and processes	S1-S14-S17-S13-S11-S22-S8-S12-S15-S28
	Monitoring flexibility	S15-S19-S30-S35
	Taking advantage of the experiences of Saramad banks in evaluation	S9-S18-S22
Supervision	Consistent and continuous monitoring of accountants' activities	S4-S22-S31-S32-S37
	Information systems and recording accountants' activities	S9-S37-S53
	Monitoring the compliance with the rules and accountants' outputs	S1-S2-S3-S4-S5-S6-S8-S19-S30-S37-S20
	Control of executive laws and regulations	S34-S37
Terms and Conditions	Formulating the necessary laws and policies for implementation	S1-S3-S5-S7-S14-S22-S39
	Creating organizational incentives to implement fair valuation	S5-S7-S10-S16-S18-S26-S29-S30-S38-S21-S25-S26-S30-S35
	Government support of the fair valuation system	S2-S4-S11-S12-S13-S20-S22-S27-S31-S32
	Alignment and integration between banks in the field of fair valuation	S3-S7-S10-S16-S18-S26-S29-S30-S38-S31-S35-S36-S10-S5
Organizational conditions	financing	S8-S12-S19-S22
	Collaborative decision-making by managers and experts in the field of fair valuation	S6-S17-S36-S33
	Providing the necessary software and hardware	S17-S18-S25-S28-S30-S34-S38-S20-S21-S24-S25
	Creation of administrative processes and automation related to fair valuer	S5-S7-S10-S16-S18-S26-S29-S30-S38-S31-S5-S46-S11-S8
Knowledge and education	Fair valuation specialization	S17-S18-S25-S28-S30-S14-S4-S20-S21-S26-S35-S38-S9-S37-S1

Categories	Open codes	Source
	Empowering bank accountants in the field of fair valuation	S1-S3-S39-S27-S26
	Increasing organizational knowledge in the field of fair valuation	S1-S11-S18-S29
	Facilitate access to necessary training resources in the field of fair valuation	S1-S11-S33-S68
Government agents	Establishing a fair valuation standard institution in the country	S1-S11-S15-S19
	Establishing a monitoring and evaluation organization for the fair valuation of banks	S1-S11-S21-S25
	Establishing laws to enforce fair valuation in order to flourish economic performance	S1-S11-S12-S19-S28-S36
	Reducing complicated and cumbersome administrative processes in the field of fair valuation	S1-S11-S28-S33
needs assessment	Identifying the existing problems of the bank based on the lack of fair valuation	S1-S40-S41-S11
	Examining the required executive procedure in the field of fair valuation	S1-S34-S37-S38-S39
	Revision of the bank's strategy and strategy in the field of fair valuation	S1-S2-S5-S7-S9-S10-S11-S15-S23-S27
Economic Growth	Creating effective tools for cost management and pricing	S4-S11-S22-S29
	Banking risk management	S1-S5-S38-S30
	Economic transparency in the bank	S1-S2-S20-S24
	Appropriate platform for rating economic units based on fair valuation	S1-S3-S5-S6-S16-S22-S27-S32
Performance transparency	Increased comparability	S32-S38-S26-S29
	Increasing banking efficiency	S1-S3-S7-S12-S16-S33
	Reduce fraud	S1-S2-S6
	Clarify financial information	S11-S14-S17

Based on Shannon's entropy method, data processing in the discussion of qualitative analysis is presented with a new look and quantitatively and qualitatively. Based on this method of data analysis, it works much stronger and more valid in content analysis. Entropy in information theory is an index to measure uncertainty expressed by a probability distribution. Based on this method, which is known as compensation model, the content of the plan will be analyzed. First, the frequency of each identified category should be determined based on content analysis. The frequency matrix should be normalized. For this purpose, the linear normalization method is used:

$$n_{ij} = \frac{x_{ij}}{\sum x_{ij}}$$

The information load of each category should be calculated. For this purpose, the following relationship is used:

$$k = \frac{1}{Ln(a)}$$

$$E_j = -k \sum \left[n_{ij} LN(n_{ij}) \right]$$

The importance coefficient of each category should be calculated. Any category with more information load is more important. For this purpose, the following relationship is used:

$$W_j = \frac{E_j}{\sum E_j}$$

Therefore, in the first step, the decision matrix is formed. The points obtained from the decision matrix regarding the issue are presented in the following table:

Table 3. *Determining the importance and emphasis of past researches*

Codes	Frequency	$\sum P_{ij} \times knP_{ij}$	Ej	Wj
Organizational flexibility	4	-0.0546	0.0132	0.0137
Revision of banking structure and processes	10	-0.1081	0.0261	0.0271
Monitoring flexibility	4	-0.0546	0.0132	0.0137
Taking advantage of the experiences of Saramad banks in evaluation	3	-0.0437	0.0105	0.0110
Consistent and continuous monitoring of accountants' activities	5	-0.0648	0.0156	0.0163
Information systems and recording accountants' activities	3	-0.0437	0.0105	0.0110
Monitoring the compliance with the rules and accountants' outputs	11	-0.1156	0.0279	0.0290
Control of executive laws and regulations	2	-0.0316	0.0076	0.0079
Formulating the necessary laws and policies for implementation	7	-0.0834	0.0201	0.0210
Creating organizational incentives to implement fair valuation	14	-0.1366	0.0330	0.0343
Government support of the fair valuation system	10	-0.1081	0.0261	0.0271
Alignment and integration between banks in the field of fair valuation	14	-0.1366	0.0330	0.0343
financing	4	-0.0546	0.0132	0.0137
Collaborative decision-making by managers and experts in the field of fair valuation	4	-0.0546	0.0132	0.0137
Providing the necessary software and hardware	11	-0.1156	0.0279	0.0290
Creation of administrative processes and automation related to fair valuer	14	-0.1366	0.0330	0.0343
Fair valuation specialization	15	-0.1431	0.0346	0.0359
Empowering bank accountants in the field of fair valuation	5	-0.0648	0.0156	0.0163
Increasing organizational knowledge in the field of fair valuation	4	-0.0546	0.0132	0.0137
Facilitate access to necessary training resources in the field of fair valuation	4	-0.0546	0.0132	0.0137
Establishing a fair valuation standard institution in the country	4	-0.0546	0.0132	0.0137
Establishing a monitoring and evaluation organization for the fair valuation of banks	4	-0.0546	0.0132	0.0137
Establishing laws to enforce fair valuation in order to flourish economic performance	6	-0.0744	0.0180	0.0187
Reducing complicated and cumbersome administrative processes in the field of fair valuation	4	-0.0546	0.0132	0.0137
Identifying the existing problems of the bank based on the lack of fair valuation	4	-0.0546	0.0132	0.0137
Examining the required executive procedure in the field of fair valuation	5	-0.0648	0.0156	0.0163
Revision of the bank's strategy and strategy in the field of fair valuation	10	-0.1081	0.0261	0.0271
Creating effective tools for cost management and pricing	4	-0.0546	0.0132	0.0137
Banking risk management	4	-0.0546	0.0132	0.0137
Economic transparency in the bank	4	-0.0546	0.0132	0.0137
Appropriate platform for rating economic units based on fair valuation	8	-0.0920	0.0222	0.0231
Increased comparability	4	-0.0546	0.0132	0.0137
Increasing banking efficiency	6	-0.0744	0.0180	0.0187
Reduce fraud	3	-0.0437	0.0105	0.0110
Clarify financial information	3	-0.0437	0.0105	0.0110

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Discussion

The purpose of this research was to examine the challenges and solutions of using fair valuation accounting in banks based on the hybrid technique. 9 main criteria and 55 sub-criteria were identified. The main criteria are flexibility, supervision, rules and regulations, organizational conditions, knowledge and training, government factors, needs assessment, economic growth and performance transparency. The flexibility criterion has codes of organizational flexibility, revision of bank structure and processes, flexibility of monitoring and benefiting from the experiences of Saramad banks in evaluation. The monitoring standard has codes for consistent and continuous monitoring of accountants' activities, information systems and recording of accountants' activities, monitoring of compliance with laws and accountants' outputs, and control of executive laws and regulations. The standard of laws and regulations has the codes of developing the necessary laws and policies for implementation, creating organizational incentives for the implementation of fair valuation, government support for the fair valuation system and alignment and integration between banks in the field of fair valuation. The standard of organizational conditions has codes for providing financial resources, collaborative decision-making by managers and experts in the field of fair valuation, providing the necessary software and hardware, and creating administrative and automation processes related to fair valuation.

The knowledge and training criteria have codes for specialization in fair valuation, empowering bank accountants in the field of fair valuation, increasing organizational knowledge in the field of fair valuation, and facilitating access to necessary training resources in the field of fair valuation. Government agents have codes to create a fair valuation standard institution in the country, create a monitoring and evaluation organization for the fair valuation field for banks, create, enforce rules for the fair valuation field in order to flourish economic performance and reduce complex and cumbersome administrative processes in the field of valuation. It is fair. The needs assessment criterion has codes for identifying the existing problems of the bank based on the lack of fair valuation, reviewing the required executive procedure in the field of fair valuation, and reviewing the bank's strategy and strategy in the field of fair valuation. The economic growth criterion has codes for creating efficient tools for cost and pricing management, bank risk management, economic transparency in the bank and proper platform for ranking economic units based on fair valuation. Performance transparency criterion has codes for increasing comparability, increasing banking efficiency, reducing fraud and clarifying financial information.

Based on the research conducted, Khan (2020) showed that fair valuation in the long term increases the profitability and reliability of the bank's performance. Donleavy (2019) found legislation necessary to complete the valuation infrastructure in the bank. Bick et al. (2017), stated that the experience of applying investment accounting standards in Iran has shown that whenever fair values become more prominent due to compliance with international accounting standards, the implementation of the standard due to The non-availability of the necessary infrastructure has been delayed. Therefore, they showed that fair valuation with education and knowledge enhancement can have better performance. Adwan et al. (2020) showed that the value relationship between profit per common share and the value relationship between profit per common share and book value in companies that used fair value is more than companies that used the cost system.

Conclusion

Under fair value accounting, management must divide all loans and securities into a maximum of three asset categories: those that are held, those that are traded, and those that are available for sale. (See the exhibit “Which Bank Assets Are Marked to Market?”) If management has the intent and ability to hold loans or securities to maturity, they are carried on the books at historical cost. Most loans and many bonds are held to maturity; they will be written down only if permanently impaired. Market discipline has become important with the liberalization and deregulation of financial markets. The market increasingly penalizes and rewards the decisions made by the board and management of listed companies. Several international organizations emphasize the benefits of stronger market discipline to society, including the role of market regulators in ensuring financial stability. To optimize the market order, the market needs information. One source of information is the accounts of the companies in question, so it is important that they provide as true and fair a view as possible. Annual financial statements should focus more on measuring and presenting current values. For financial companies, this increased focus on current values means that the fair value principle has been introduced as the new valuation principle. Greater use of current values in financial statement presentation supports opportunities for the market to exercise control.

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