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# The State of Fair Value Accounting, Global Financial Crisis and Implications to Thailand

By

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## I. Introduction

Accounting is not the mere mirror of direct cause of the world economic crisis, but it is important for the participants of market to well understand what accounting information presented in the financial statement. In this paper, particularly, fair value accounting (FVA) in itself and the importance concepts around recent financial crisis will be discussed. The concept of FVA is not “new” but historically FVA has had been replaced to historical cost accounting long time ago in the United States<sup>1</sup>. It is well-known that the foundation of accounting has long been the recording of historical costs. Only in recent decades, modern accounting has shifted its emphasis from financial record (HCA) to financial report (FVA). As we will discuss in the following sections, both methods have their own strength and limitation. Therefore, it is necessary to take their basic assumptions and their main purposes into account when we discuss the relevance of them.

As is commonly known, the whole calculation regime is changing in our socio-economy under the IAS/IFRS which pursues for the sake of international transparency, international comparability and subsequent efficiency of the world’s financial markets (Biondi & Suzuki, 2007). Form the perspective of decision makers or investors, the FVA based information has been considered as more transparent and fair. However, since FVA relies heavily on the efficient market hypothesis, the recent financial turmoil gives warning on FVA basic assumptions and many countries have started conducting amendment on the application of FVA on financial assets. This paper aims to depict some insights for current financial crisis from the accounting point of view: why does the fair value accounting matter in the period of the financial crisis and what are the implications for Thailand?

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<sup>1</sup> It is well known that the USA has long predominantly supported historical cost accounting for inventories and fixed assets.

## II. HCA and FVA

### 1. Some preliminaries

#### *The concept of historical cost accounting*

Historical cost is the original monetary value of an economic item<sup>2</sup>. In some circumstances, assets and liabilities may be shown at their historical cost, as if there had been no change in value since the date of acquisition. In fact, until recently, historical cost (i.e. book value) was predominantly reliant, rather than the fair value (i.e. market value) to calculate profits, because accountants did not want to recognize an unrealized profit<sup>3</sup> which is generated from the external market factor. This idea is conventionally supported by stewardship<sup>4</sup>.

Historical cost accounting (HCA) views value as generated in business purchasing inputs, transforming them according to a business plan, and selling the consequent product over cost; in short, value is added by arbitraging prices in input and output markets for goods and services according to a business plan. HCA does not report the (present) value of expected outcomes from the business plan. Rather, it reports on progress that has been made in executing the plan, recognizing value added (earnings) from actual transactions in the input and output markets being arbitrated. The income statement comes to the fore with a matching of revenues (value received from transaction exit prices) with costs. The balance sheet is not a statement of values (for the large part), by design, but rather a by-product of this matching, with liabilities such as accrued expenses, deferred revenues, and deferred taxes gaining their legitimacy from the matching process rather than as representations of the value of obligation (Penman, 2007, pp.36-37).

#### *The concept of fair value*

Fair value accounting (FVA) is a way to measure assets and liabilities that appear on a company's balance sheet and income statement. Fair value is defined "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" (FAS 157). FAS 157 emphasizes the use of market inputs in valuing an asset or liability. Examples of specific market inputs mentioned include: quoted prices, interest rates, yield curve, credit data, etc. Fair value is, by definition, derived from a current transaction which happens in an active market with knowledgeable and unrelated parties. When fair value is not available due to the lack of an actual transaction, it is logical to use

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<sup>2</sup> The term, historical cost, is unfortunately pejorative. A better term, one that captures, the essence, is 'historical transactions accounting', for the accounting reports a history of transactions, and it is that history of engaging with markets from which valuations are made and management performance assessed (Penman, 2007, p.37).

<sup>3</sup> Unrealized profit is a potential profit that has not yet been affected (i.e., a paper profit). Suppose an investor buys 25 shares of stock at \$2 each on October 14. On October 22, the price is \$3 per share. The unrealized profit is  $25 \times (\$3 - \$2)$ , or \$25. An unrealized profit is ordinarily not taxed until the stock is sold and the profit realized. From the standpoint of investor psychology, though, an unrealized profit can pose problems: if the shares subsequently decline, some investors won't sell the stock until the price is again \$3 and they have the same unrealized profit.

<sup>4</sup> Stewardship is a traditional approach of accounting that places an obligation on stewards or agents, such as directors, to provide relevant and reliable financial information relating to resources over which they have control but which are owned by others, such as shareholders.

information from an active market. However, sometimes quoted prices might not represent the best estimate of fair value.

As a result of some social and economic factors (such as, the development of complex financial assets, the influence of inflation, the announcement of ASOBAT (1966; A Statement of Basic Accounting Theory)) through the 1960 and 70s, the intricacy of forecasting and estimates came into accounting practice at an unprecedented level, and the profits have come to be recognized earlier and earlier before they are actually realized (Ijiri, 2005, pp.259-263). Besides, in terms of disclosure fair value has got attention from investors. Disclosure in accounting context means that firms should supply along with their financial statements material information that may affect investors' decisions. With the passage of time, the notes to the financial statements have become synonym to the concept of full disclosure. The paradigm of FVA provides a more complete full disclosure and it is compatible with transparency<sup>5</sup>.

Table 1 briefly shows key features of HCA and FVA.

Table 1 Key features of HCA and FVA

	HCA (Historical Cost Accounting)	FVA (Fair Value Accounting)
Key features	<ul style="list-style-type: none"> <li>- Stewardship                             <ul style="list-style-type: none"> <li>· European tradition</li> </ul> </li> <li>- Income-Statement</li> <li>- Exclusion of unrealized profit                             <ul style="list-style-type: none"> <li>· Distributable profit</li> </ul> </li> <li>- Confirmatory value                             <ul style="list-style-type: none"> <li>· transaction based</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Investment Decisions                             <ul style="list-style-type: none"> <li>· ASOBAT (1966)</li> </ul> </li> <li>- Balance-Sheet</li> <li>- Inclusive of unrealized profit</li> <li>- Predictive value                             <ul style="list-style-type: none"> <li>· present values, models, and estimates</li> </ul> </li> <li>- disclosure</li> </ul>

## 2. Historical debate in the USA: HCA or FVA?

A discussion of either “historical cost accounting” or “fair value accounting” is not a new topic. Prior to the 1930 in USA, banks and other financial institutions were required to report their loans and financial holdings at market values. During the economic recession in the late 1920s the market values of these assets have dropped. Banks had to mark down their holdings, report losses and reduce their capital. Four years after the world economic crisis, the Securities Act of 1933 was passed. This was followed by the Securities and Exchange Act of 1934, leading to the establishment of the Securities and Exchange Commission (SEC). Since the SEC was established in 1934, it had maintained a view that documents submitted to SEC should not include anything other than historical facts. Indeed, from its founding in 1934 until the 1970s the SEC disapproved of most upward revaluations and general price-level restatements of fixed assets as well as depreciation charges based thereon (Zeff, 2007, p.49)

However, in a period of high inflation in the 1970s, the need of fair value came to be discussed among both academics and businessmen with two reasons: first, many of

<sup>5</sup> Accounting transparency, in FASB context, means that the financial statements provide, true, accurate, and complete information about the business activities and the financial position of a firm.

the historical cost appearing on financial statements are not economically relevant because prices have changed since they were incurred. Second, since the numbers on financial statements represent dollars expended at different points of time and, in turn, embody different amounts of purchasing power, they are simply not additive<sup>6</sup>. These opinions urged SEC to pay more attention to FVA.

Another boom of fair value accounting re-arose in the mid-1980s because of a fact that the markets for many commodities and financial instruments, including derivative, have become substantially deeper and more liquid. The value of those financial assets and liabilities, instead of non-monetary assets, has typically involved both upward and downward movements. Eventually, current FVA related rules were established in the 1990s.

In sum, the adoption of fair value and historical cost has been historically impacted by economic and social situations such as the economic depression, inflation, and the diversity of financial assets.

### 3. What are problems between HCA and FVA?

#### *Standardization: the standard setter*

International Financial Reporting Standards (IFRS) are standards which are used in many parts of the world, including the European Union, Hong Kong, Australia, Malaysia, Pakistan, India, Gulf Cooperation Council (GCC) countries, Russia, South Africa, Singapore and Turkey<sup>7</sup>. As of August 27, 2008, more than 100 countries around the world, including all of Europe, currently require or permit IFRS reporting. Approximately 85 of those countries require IFRS reporting for all domestic, listed companies.

Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IAS was issued between 1973 and 2001 by the board of the International Accounting Standards Committee (IASC). In April 2001 the IASB adopted all IAS and continued their development, calling the new standards IFRS. In this sense, the whole accounting regime is changing in our society under the IAS/IFRS. In fact, the IASB is simply pursuing their objective as a matter of normal conduct of standardization. They have rights to do so, and they believe it is ‘for the public.’

The current trend around the IASB circle is to say that the market value is ‘fair’ for investors who require up-to-date information of assets and liabilities (and therefore the Net Assets) to estimate appropriate share prices (Biondi and Suzuki, 2007, p.590). Thus, the focus has been on the limited member groups of “the global community”

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<sup>6</sup> It generally is understood that FVA measures and discloses the current value of assets and liabilities, and it tends to be considered more relevant. Some academic literatures have started to mention that fair values of certain financial instruments should be included in the balance sheet and that changes in the fair values of these instruments should be in the income statement (AAA’s Financial Accounting Standards Committee, 1998).

<sup>7</sup> In 2008, the Securities and Exchange Commission announced that the US will abandon GAAP by 2016, with the largest companies switching to IFRS as early as next year.

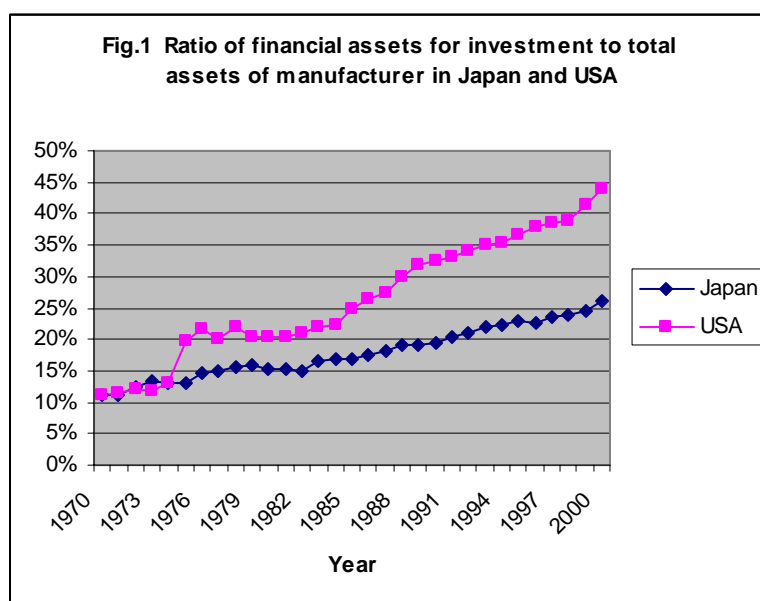
(Biondi and Suzuki, 2007, p.593). However, there are many different stakeholders such as employees, labour unions, banks, tax office, regulatory agencies, environmentalists and so forth who either support or object to the proposed change based on their different interests (Biondi and Suzuki, 2007, p.595).

The whole calculation regime is changing in our socio-economy under the IAS/IFRS. What are the overall impacts of Fair Value Accounting on wider stakeholders and the socio-economy at large? Is the Fair Value 'fair' or 'useful', to whom, in what ways? Quite simply, we have not had serious discussions over these questions. Nor has any empirical evidence been presented (Ball, 2005), although the IAS/IFRS have steadily been implemented in many countries. (Biondi and Suzuki, 2007, p.590).

### *Changes in asset composition of manufacturing firms in US and Japan*

The call for valuation of financial assets at their fair value has gained growing support in the United States since the 1980s and led to the introduction of fair value accounting in the 1990s for marketable securities.

The share of financial assets as a proportion of total assets has grown significantly in the past three decades. Financial assets, including cash and deposits, trading receivable, and securities, are invariably contractual rights, and are exposed to financial risk involving credit, interest rates, and price changes. These characteristics set financial assets apart from non-financial assets. The ratio of financial asset for investment, such as monetary claims and securities, to total assets has all but constantly grown over the past 30 years among manufacturing firms in both Japan and the United States (see. Fig.1). Japanese manufacturers have raised their ratio from approximately 11% at the end of the 1960s up to roughly 26% at the end of the 1990s, while their US counterparts similarly lifted their figures from about 11% at the end of the 1960s to around 44% at the end of the 1990s.



Source: Ishikawa (2005), p.129

## III. Recent Financial Turmoil and the Accounting Rules

## 1. The beginning of the turmoil

The subprime crisis in the US has finally snowballed into an unprecedented liquidity crisis and a financial market meltdown. Stock and realty prices across the world are in a state of freefall, destroying billions of dollars of investors' wealth. At this juncture, the worst hit is the banks and other financial institutions which possess a substantial amount of investments in CDO (collateralized debt obligation<sup>8</sup>), CDS (credit default swap<sup>9</sup>), corporate equity, MBS (mortgage-backed instruments<sup>10</sup>) and other derivative products<sup>11</sup>. Equity markets have seen liquidity ebb away. Amid this distressing financial market scenario, the fair value accounting model adopted as the basis of financial reporting under the US GAAP (Generally Accepted Accounting Principles) and the International Financial Reporting Standards (IFRS) are being undermined.

The most important parameter when determining fair value of financial assets is observable market price. In a reeling market, there is no reliable quotation to bank upon and one can't go by the market price a similar security fetches in a distress sale. The US and European bankers are finding safe shelters for their trading portfolio, mostly comprising of equity shares. In a rising market, the portfolio value increased quarter-by-quarter. As per the fair value accounting norm, such unrealized appreciation in the portfolio was booked as a profit. Now with markets, the situation is just the opposite-quarter-by-quarter there is fair value loss in the trading portfolio.

Unrealized fair value loss should be charged to the income statement. Banks would therefore report very poor financial results resulting in markets falling further. Moreover, this mark to market accounting rule is hurting capital adequacy of many banks requiring re-capitalization.

It is exacerbating the global financial crisis by further depressing financial assets and making it harder for companies to access capital in markets where capital has evaporated. Actually, huge losses reported by financial firms on subprime assets have led to a debate over the implementation of SFAS 157 in circumstances where markets collapse and price inputs are not readily available. In the current crisis, many financial institutions have had to reduce the value of the mortgages and mortgage-

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<sup>8</sup> An investment-grade security backed by a pool of bonds, loans and other assets. CDOs do not specialize in one type of debt but are often non-mortgage loans or bonds.

<sup>9</sup> A credit default swap (CDS) is a credit derivative contract between two counterparties. The buyer makes periodic payments to the seller, and in return receives a payoff if an underlying financial instrument defaults. CDS contracts have been compared to insurance, because the buyer pays a premium, and in return receives a sum of money if a specified event occurs. However, this is a slightly misleading comparison because the buyer of a CDS does not need to own the underlying security; in fact the buyer does not even have to suffer a loss from the default event.

<sup>10</sup> A mortgage-backed security (MBS) is an asset-backed security whose cash flows are backed by the principal and interest payments of a set of mortgage loans. Payments are typically made monthly over the lifetime of the underlying loans. However not all securities backed by mortgages are considered mortgage-backed security (MBS). Housing Bonds (Mortgage Revenue Bonds) are backed by the mortgages which they fund, but aren't classified as mortgage-backed security (MBS).

<sup>11</sup> For instance, in 2007 Morgan Stanley has the equivalent of 251% of its equity in Level 3 assets, Goldman Sachs has 185%, Lehman Brothers has 159%, Citigroup has 105%. On the other hand, Merrill Lynch has Level 3 assets equal to 38% of its equity. By contrast, it is said that Level 1 assets had been less than 30% of the total financial assets.

backed securities to reflect current prices. Those prices declined severely with the collapse of credit markets as mortgage defaults escalated. Fair value accounting requires financial institutions to value their mortgage-related assets at current market prices.

## 2. FAS 157: the fair-value measurement standard

Statement of Financial Accounting Standard (SFAS) 157 was issued in 2006 by the Financial Accounting Standards Board (FASB)<sup>12</sup> effective for fiscal year 2008, starting 15 November 2007. FAS 157 applies to financial assets of all publicly-traded companies in the U.S. as of Nov. 15, 2007. It also applies to non-financial assets and liabilities that are recognized, or disclosed, at fair value on a recurring basis. FAS 157 applies to items for which other accounting pronouncements require or permit fair value measurements except share-based payment transactions, such as stock option compensation.

### *Three level hierarchy*

FAS 157 provides a hierarchy of three levels of input data for determining the fair value of an asset or liability. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets (such as a stock traded on the NYSE) or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly (such as an interest-rate swap where its components are observable data points like the price of a 10-year Treasury bond). Level 2 inputs include:

- a. Quoted prices for similar assets or liabilities in active markets;
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (i.e. some brokered markets), or in which little information is released publicly (i.e. a principal-to principal market);
- c. Inputs other than quoted prices that are observable for the asset or liability (i.e. interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates);
- d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs)

Level 3 consists of unobservable inputs for the asset or liability such as those that reflect the reporting entity's own assumptions about what market participants would use to price the asset or liability (including risk), developed using the best information available without undue cost and effort, according to FASB.

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<sup>12</sup> FASB (established in 1972) is an independent and private organization from the US government. They have announced lots of the US accounting standards.

Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situation 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. Therefore, unobservable inputs shall reflect the reporting entity's own assumption about the assumptions that market participants would use in pricing the asset or liabilities (including assumption about risk).

Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions.

However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue costs and effort that indicates that market participants would use different assumptions.

### ***The amendment of FAS 157***

FAS 157 was blamed for the financial crisis where many financial institutions mentioned that the standard forces financial institutions to mark to market their positions in an inactive market where the fair values are not representative of the true value of the asset. On 30 September 2008, the SEC board decided to mitigate the American fair value measurement, especially their attention was put on level 3 assets.

It tackles some of the most difficult areas of judgment that must be exercised when active market prices are unavailable. It recognizes that the challenges faced by preparers of financial statements and their auditors when weighing level 2 (observable) and level 3 (unobservable) inputs for fair value determinations are real and provides assistance in resolving them. For example, the amendment clarifies that:

When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable. In some cases, multiple inputs from different sources may collectively provide the best evidence of fair value. In these cases, expected cash flows would be considered alongside other relevant information. The weighting of the inputs in the fair value estimate will depend on the extent to which they provide information about the value of an asset or liability and are relevant in developing a reasonable estimate.

Broker quotes may be an input when measuring fair value, but are not necessarily determinative if an active market does not exist for the security. In a liquid market, a broker quote should reflect market information from actual transactions. When

markets are less active however, brokers may rely more on models with inputs based upon the information available only to the broker. In weighing a broker quote as an input to fair value, an entity should place less reliance on quotes that do not reflect the result of market transactions. Further, the nature of the quote (e.g., whether the quote is an “indicative” price or a binding offer) should be considered when weighing the available evidence.

The results of disorderly transactions are not determinative when measuring fair value. The concept of a fair value measurement assumes an orderly transaction between market participants. An orderly transaction is one that involves market participants that are willing to transact and allows for adequate exposure to the market. Distressed or forced liquidation sales are not orderly transactions, and thus the fact that a transaction is distressed or forced should be considered when weighing the available evidence. Determining whether a particular transaction is forced or disorderly requires judgment.

All of these clarifications further the immediate purpose — to assist those who must make difficult decisions in arriving at fair values for financial statement reporting. They also serve as a defense of the fair value standard, in an effort to show that the current valuation challenges can be addressed reasonably under the fair value hierarchy and other standards established by SFAS No. 157.

## 2. IAS 39

IAS 39, *Financial Instruments: Recognition and Measurement*, requires financial assets to be classified in one of the following categories, which determine how a particular financial asset is recognized and measured in the financial statements:

- Financial assets at fair value through profit or loss (FVTPL);
- Available-for-sale financial assets (AFS) – fair value through other comprehensive income;
- Loans and receivables (L&R) – measurements based on contracted-for amounts;
- Held-to-maturity investments (HTM) – measurements based on investment cost.

### ***Amendments to IAS 39 & IFRS 7 –reclassification of financial assets***

In response to a fact that FASB amended their accounting standard in the end of September 2008, IASB (International Accounting Standard Board)<sup>13</sup> decided to

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<sup>13</sup> The IASB was established in 2001 and is the standard-setting body of the International Accounting Standard Committee (IASC) Foundation, an independent private sector, not-for profit organization. The

mitigate their standard IAS 39 (Financial Instruments: Recognition and Measurement) and IFRS 7 (Financial Instruments; Disclosure), which is adopted by more than 100 countries, on 13 October 2008. The changes to IAS 39 permit an entity to reclassify non-derivative financial assets out of the 'fair value through profit or loss' (FVTPL) and 'available-for-sale' (AFS) categories in limited circumstances. Such reclassifications will trigger additional disclosure requirements.

### ***Scope of the amendments***

The amendments will only permit reclassification of **certain non-derivative financial assets** recognised in accordance with IAS 39. Financial liabilities, derivatives and financial assets that are designated as at FVTPL on initial recognition under the 'fair value option' cannot be reclassified. The amendments therefore only permit reclassification of debt and equity financial assets subject to meeting specified criteria. The aforementioned clarifications of IAS39 concern the following issues:

#### ***- Using the reporting entity's own assumption when relevant market inputs do not exist***

In an inactive market, it is justifiable to use the reporting entity's own assumptions for future cash flows and discount rates, appropriately adjusted for the risks that any market participant would take into account (notably counterparty risk, non-performance risk, liquidity risk and model risk). Such adjustments are made in a reasonable and appropriate manner after examining the available information.

#### ***- Using broker quotes when assessing available information***

Broker quotes are not necessarily representative of fair value in an inactive market if they do not reflect the transactions taking place on that market.

#### ***- Taking forced transactions into account when assessing fair value***

Transactions resulting from involuntary liquidations or distressed sales must not be taken into account to determine the fair value of a financial instrument.

When markets are illiquid, it is not appropriate to conclude that all market activity represents involuntary liquidations or distressed sales. However, neither is it appropriate to conclude that any transaction price is automatically determinative of fair value.

Determining whether a transaction is an involuntary liquidation or distressed sale requires judgment.

#### ***- The role of observable transaction prices in an inactive market***

The prices of the few transactions executed in an inactive market are an input to be taken into account when pricing a financial instrument, but they are not necessarily determinative.

In any case, determining whether a market is active or not requires judgment. This can be based on indicators such as a sharp decline in trading volume and the level of

activity in the market, a sharp disparity in prices over time and between various market participants, or the fact that prices no longer correspond to sufficiently recent transactions.

The amended rule can be applied in the last July 2008. Possibly, EU companies could get losses of stock value smaller in the third quarter (July-September) accounting period of 2008.

### ***Reclassification out of FVTPL and AFS***

A financial asset within the scope of these amendments can only be reclassified out of FVTPL or AFS if specified criteria are met. The criteria vary depending on whether the asset would have met the definition of 'loans and receivables' (L&R) had it not been classified as at FVTPL or AFS at initial recognition.

A debt instrument classified as AFS that would have met the definition of L&R (if it had not been designated as AFS) may be reclassified to the L&R category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Any other debt instrument, or any equity instrument, may be reclassified from FVTPL to AFS, or from FVTPL to HTM (in the case of debt instruments only), if the financial asset is no longer held for the purpose of selling in the near term – but only **in 'rare' circumstances**. In its press release the IASB acknowledged that market conditions in the third quarter of 2008 are a possible example of a 'rare' circumstance.

It should be noted that the amendments do not refer to the reclassification of AFS debt instruments to HTM because IAS 39 already permitted such reclassifications (see IAS 39.54). These reclassifications are not within the scope of the current amendments, and therefore they do not trigger the additional disclosures required by IFRS 7.12A referred to below.

### ***Disclosures of IFRS***

To make transparent to users any reclassifications under the new requirements, IFRS 7 is also amended. Although the requirements for reclassifications in accordance with IAS 39.51-54 remain unchanged (IFRS 7.12), the following additional disclosures are required for reclassifications within the scope of the current amendments (new paragraph IFRS 7.12A):

- the amount reclassified into and out of each category;
- for each reporting period until derecognition, the carrying amounts and fair values of all financial assets reclassified in the current or previous reporting periods;
- if the financial asset has been reclassified based on the 'rare circumstances' exception, details of those circumstances – including the factors that indicated that the situation was rare;
- the fair value gain or loss recognised in profit or loss or OCI for the reporting period in which reclassification occurs and in the previous period;
- in the period of reclassification and in subsequent periods until the financial asset is

derecognised, the gain or loss that would have been recognised in profit or loss or OCI had the financial asset not been reclassified, and the actual gain, loss, income and expense recognised in profit or loss; and

- the effective interest rate and estimated cash flows the entity expects to recover as at the date of reclassification of the financial asset.

### ***Dates***

These amendments are effective from 1 July 2008. Entities are not permitted to reclassify financial assets in accordance with the amendments before 1 July 2008. The amendments state that any reclassification of a financial asset made in periods beginning on or after 1 November 2008 will take effect only from the date when the reclassification is made. Any reclassification of a financial asset in accordance with the amendments should not be applied retrospectively to reporting periods ended before the effective date.

The following table illustrates how reclassification will be dealt with following this announcement by IFRSs when compared with US GAAP.

	<b>US GAAP</b>	<b>IAS 39 Amendments</b>
Reclassification of securities out of the trading category in rare circumstances	Permitted	Permitted
Reclassification to loan category (cost basis) if intention and ability to hold for the foreseeable future (loans) or until maturity (debt securities)	Permitted	Permitted
Reclassification if fair value option previously elected	Not permitted	Not permitted

## **IV. Implications to Thailand**

### ***Form a task forth***

By considering the turmoil in the world financial markets and international movement of revising a rule that requires banks to account for assets in line with market prices, which has led to big changes on mortgage-backed securities, Thailand would need to change its rules on fair-value accounting and to proceed with its deliberation through **communication** with constituents on an urgent basis, in addition to monitoring the development made by the internationally recognized accounting setters. As we can see EU and Japan's case above, major countries have just started to address this issue by setting up the special task force. Therefore Thailand is also **required to form a professional study team** (from a variety of professionals such as accountants, practitioners from industries, politicians, academics and lawyers). Since accounting is not mere a tool to measure "single economic reality (Reality)" but a technology to visualise some aspects of **realities**, the trade-off between tightening of accounting regulations (strictly applying fair value accounting, for example) and negative impact on the industry competitiveness should be considered from multiple perspectives. As many of us have been noticed and warned that accounting should be considered as social, institutional, political and organizational practices.

### ***Distinction between productive capital and capital credit***

As Ishikawa (2005, p.121) indicates, the bulk of today's accounting problems stems not from within productive capital –as in the case of accounting for fixed assets, notably depreciation –but rather from the outside, that is, from the process of transforming idle monetary capital into productive capital, or what is termed “capital credit”:

“that credit which converts idle money of whatever kind (whether cash or credit money) into active money capital is called capital (or investment) credit, because it is always a transfer of money to those who use it, through the purchase of the various elements of productive capital, as money capital ... As capitalist credit, however, it puts money into circulation only in order to withdraw more money. It puts money into circulation as money capital in order to convert it into productive capital. Thus it expands the scale of production, and this expansion presuppose the expansion of circulation (Hilferding, 1981, p.87; cited from Ishikawa, 2005, p.121)”

For such capital credit to exist, there must be a circulation system which ‘puts money into circulation only in order to withdraw more money.’ And that is precisely what financial instruments such as equity securities are designed to accomplish; to put money into circulation only in order to withdraw more money –a process typified by speculation (Ishikawa, 2005, p.121).

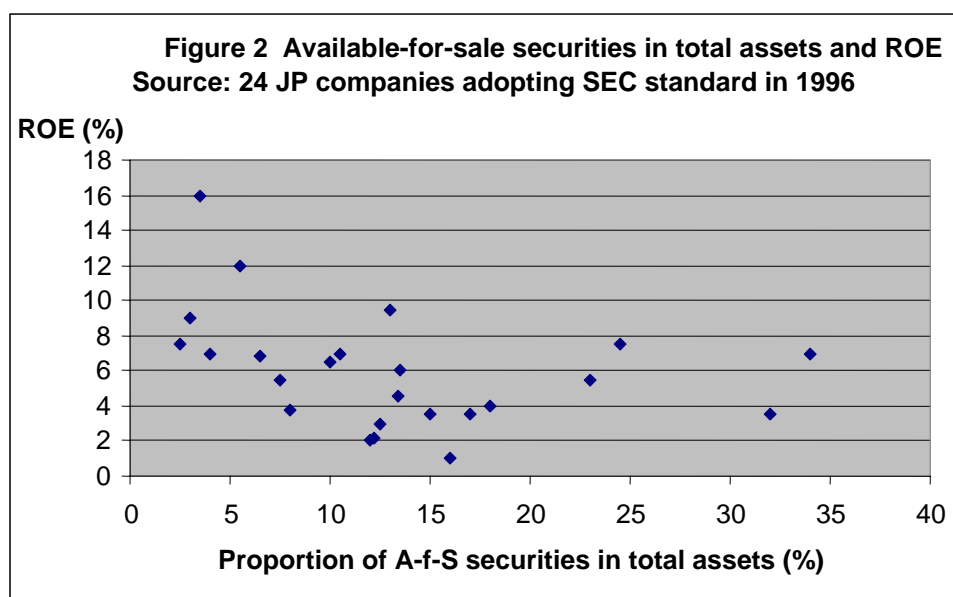
### ***Available-for-Sale Security in Total Assets and ROE***

It is said that financial assets would be most influenced by fair value measurement and some of them were thought as a main cause of current financial crisis. Hence for Thailand to cope with current financial turmoil and prepare for the potential problems, figuring out the proportion of financial assets in total assets of Thai firm becomes important. Here is an example of how we may analyse this. The analysis used 24 Japanese companies<sup>14</sup> which had adopted US standard. The figure indicates a fact that companies having a high rate of available-for-sale securities tend to be the right side of the figure by contrast companies having a low rate of available-for-sale securities to be the left side of the figure<sup>15</sup>. The companies on the left side indicate that they can earn profit from their original business (organic turnover) rather than available-for-sale securities.

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<sup>14</sup> 24 companies are Fuji film, Komatsu, Kubota, Toshiba, Mitsubishi Electronics, Makita, NEC, Sony, TDK, Sanyo, Canon, Honda etc.

<sup>15</sup> According to FAS 115, an enterprise shall classify securities into one of three categories: held-to-maturity, available-for-sale, or trading. Two categories apart from held-to-maturity are regarded as sellable securities.



### Maintain liquidity of market

The role of financial institution is significant in maintaining a liquidity of market. Although it is said, as the proportion of these assets on balance sheet is significantly low comparing to US financial institutions, that the effect of current problematic securitised financial assets so-called toxic assets such as CDO, CDS, corporate equity, MBS (mortgage-backed instruments<sup>16</sup>) and other derivative products are much less to Thai bank, Thailand should take in-direct negative effect on Thai economy into account. In addition to this, As Pongsak et al. (2008) pointed out that recognizing a network in banks of interlinked balance sheets has become significant.

### Our View

It can be expected that the accounting of object economy have been eroded to the accounting of the monetary economy so to speak when applying it to the world of accounting. We should not confuse information “disclosure” (provision of information, A Statement of Basic Accounting Theory so-called ASOBAT 1966) with the accounting “calculation” (the adjustment of interest). Strengthening information disclosure and the evolution of the accounting calculation is not same thing. The feature of recent accounting movement is that the information disclosure intention has come out strongly forward. In the accounting standard (rule), there are a standard related to the accounting calculation and a standard related to disclosure. The request to a latter rule has risen relatively today. The main reasons are in diversity, the upgrade, and the complication (expansion) of the monetary economy rather than the influence of the object economy. In such a situation, the evaluation judge function is also requested under the name of the accounting and the audit.

Personally we believe that finance is supposed to play a supportive role for growth of object economy. Originally, computational or mathematical finance was for object

<sup>16</sup> A mortgage-backed security (MBS) is an asset-backed security whose cash flows are backed by the principal and interest payments of a set of mortgage loans. Payments are typically made monthly over the lifetime of the underlying loans. However not all securities backed by mortgages are considered mortgage-backed security (MBS). Housing Bonds (Mortgage Revenue Bonds) are backed by the mortgages which they fund, but aren't classified as mortgage-backed security (MBS).

economy to hedge the risk of creation of credit. Ironically, this “advanced scientific approach” drove up current financial crisis (as one of the most significant factors). What the world needing now is not engineering (skill) but a philosophy (thought), ethics rather than technique. The object economy bears the value creation, and there is finance only to support it (at least originally it was so). The philosophy for improving society is supposed to play more significant role and this is the original ideal way of scholarship hence power of wisdom. The evolution of the technology (e.g., mathematical financial tool) does not make the person happy at once. The present-day that the opposite has occurred is good example of this.

As many social constructivist research on accounting have been pointed out that the economic, political, institutional and social consequences of accounting practice may no longer be ignored as substantive issue in the setting of accounting standards (e.g., Hopwood et al. 1994, Zeff 1978). Developing theoretical resources in order to be able to adequately confront this issue has become important. The related arguments from such perspectives are shown in such journals as *Accounting, Organizations and Society* (est. 1976), *Accounting, Auditing, and Accountability Journal* (est. 1988) and *Critical Perspectives on Accounting* (est. 1990). These journals have certainly come to influence the thinking of some economists, sociologists, political scientists and even philosophers (Biondi & Suzuki 2007). However, in similar manner as un-critical direct implementation of International Accounting Standard to Thailand, the academics in Thailand do not seem to aware the importance of these important shifts in approach to social science rather they were still narrowly restricted with natural science methods based approach without taking their crucial failing into careful consideration.

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Appendix