

## **COGNITIVE THEORIES OF KNOWLEDGE TOTAL FAIR VALUE IN EVALUATION**

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**Abstract:** The foundation of fair value represents the entity following the business principle with out having any intention or any need of liquidating or eliminating the size of its operation or engaging in an operation that will never have a negative result. And so fair value is not the value which an entity would receive or pay in a forced transaction, involuntary liquidation or forced sale. Although, fair value represents the quality of credit instrument. The fair value is the value through which an asset can be proceeded or a debt can be erased, between interested and conscious parts when it comes to a transaction made in fairly conditions.

**Keywords:** methods, management, knowledge, risk, information

An entity must show the fair value of the particular class of assets and debts in a way that can allow them to be realized in a comparison with their accounting value. When an entity presents the fair values, it has to assort the assets and financial liabilities in classes, but these will be compensated only if their accounting values are compensated in the balance sheet.

An entity shall present:

(a) the methods and, when a evaluation technique is used, the assumptions applied in determined the fair values of each class of financial assets or financial liabilities. For example, when appropriate, an entity reveals information about payment rates, rates of estimated credit losses and interest rates or discount rates.

(b) whether fair values are determined, in whole or in part, by direct reference to public price quotations in an active market or are estimated using a valuation technique.

(c) whether the fair values recognized or presented in the financial statements are determined, in whole or in part using a valuation technique that is based on assumptions that are not supported by prices from observable current market transactions involving the same instrument and not based on available observable market data. For fair values that are not recognized in financial statements if by replacing one or more assumptions with a possible alternative would result a significant change in fair value, it shall declare that fact and will show the effect of those changes. In this case, the importance will be appreciated with relation to the profit or loss and with relation to assets and total liabilities, or where changes in fair value are recognized in equity, in relation to equity.

(d) if the paragraph above is applied, the total change in fair value recognized in profit or loss during the period, estimated using a valuation technique.

If the market for a financial instrument is not active, the entity establishes the fair value of the instrument using a evaluation technique. The best proof of fair value at first recognition is the proceeding price. There for there could be a difference between fair value at first recognition and the value determined at that certain time using a evaluation technique. If there is any difference of this kind, an entity will shoe, for every class of financial instruments:

(a) its accounting policy for recognition of that difference in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price.

(b) the aggregate difference that remains to be recognized in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

Presentations of fair value are not necessary:

- (a) when the carrying amount is a reasonable approximation of fair value, for example, financial instruments such as trade receivables and payable liabilities;
- (b) for an investment in equity instruments that do not have a quoted market price in an active market for derivatives related to such equity instruments, which are valued at cost in accordance with IAS 39 because as fair value can not be reliably evaluated, or
- (c) for a contract containing a discretionary participation feature if the fair value of the feature can not be reliably measured.

In the cases described above, an entity shall disclose information to assist users of financial statements to make their own argument about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

- (a) that the fair value information was not presented for these instruments because their fair value can not be measured reliably;
- (b) a description of financial instruments, their carrying value, and an explanation of why fair value can not be measured reliably;
- (c) information on the market for such instruments;
- (d) information on the entity's intention to dispose of financial instruments and how they will fail, and
- (e) if the financial instruments whose fair value previously could not be reliably measured are derecognised, their book value at the time of derecognition, and the amount of gain or loss recognized.

Standard 39: Financial Instruments: Recognition and Measurement "uses the terms" offer price "and" asking price "(sometimes called the" current bid price) in the context of quoted market prices and the term "best bid" that include only transaction costs. Other adjustments made to arrive at fair value (for example, counterparty credit risk) are not included in the term "best bid".

A financial instrument is any contract that generates both a financial asset of one entity and a financial liability or equity instrument to another entity.

I established the following additional guidance on how fair values can be determined using specific assessment techniques:

- Objective is to establish what the transaction price would have been on hand in case of an evaluation conducted on objective motivated by normal business considerations;
- A valuation technique (a) incorporates all factors that market participants would consider in pricing and (b) is consistent with accepted economic methodologies for evaluating financial instruments;
- In applying valuation techniques, an entity uses estimates and assumptions that are consistent with available information on estimates and assumptions that market participants would use in pricing the financial instrument;
- The best estimate of fair value on initial recognition of a financial instrument that is not quoted on an active market is the transaction price, unless the fair value of the instrument is evidenced by other observable market transactions or based on a technique assessment of which variables include only data from observable markets.
- Fair value of liabilities with a feature to be "on demand", e.g. a deposit account is not less than the amount payable on demand, discounted from the first time since that could require the payment amount.

**Adoption of fair value for the four categories of financial instruments.**

Investments in equity that do not have a quoted market price in an active market and whose fair value can not be measured reliably are not designated at fair value through profit or loss.

**The investments held to maturity** are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intent and ability to hold to maturity other than:

- (a) those who, on initial recognition, the entity designates as at fair value through profit or loss;
- (b) those that the entity designates as available for sale, and
- (c) those that meet the definition of loans and receivables.

An entity shall not classify financial assets as held to maturity if the entity has sold or reclassified in the current financial year or previous two years, more than an insignificant amount of investments held to maturity (more than insignificant compared with the total value of investments held to maturity), other than sales or reclassifications that:

- (i) are so close to maturity or time-limited financial assets, as market interest rate changes have no significant effect on the fair value of financial assets;
- (ii) occur after the entity has collected most of the original capital asset by payment or prepayment, or
- (iii) is attributable to an isolated event that is beyond the control of the entity, not repetitive and could not reasonably have been anticipated by the entity.

**Loans and receivables** are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- (a) those that the entity intends to sell immediately or soon enough, the ones that can be classified as held for trading, and the entity on initial recognition, designates as at fair value in profit or loss;
- (b) those that the entity at initial recognition designates them as available for sale, or
- (c) those for which the holder may not recover substantially all the initial investment, otherwise than because of credit deterioration, which will be classified as available for sale.

An interest acquired by the pooling of assets are loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable.

**Financial assets available for sale** are those non-derivative financial assets that are determined to be available for sale or not classified as (a) loans and receivables, (b) investments held to maturity or (c) financial assets at fair value through account profit and loss.

#### **Considerations regarding the evaluation at fair value**

The best evidence of fair value are the quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would be obtained at the measurement date in a transaction carried out on objective motivated by normal business considerations. Evaluation techniques include using recent market transactions conducted in objective conditions between the parties concerned and knowledgeable, if any, references to current fair value of another instrument which is mostly the same, a cash flow analysis settled and optional pricing models. If there is a valuation technique commonly used by market participants to determine the price of an instrument and if that technique has been shown to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique used to maximum market data inputs and relies as little as possible on entity-specific data inputs. It incorporates all factors that market participants would consider in pricing and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, the entity shall adjust the valuation technique and tested for validity using prices from observable current market transactions for the same

instrument (ie without modification or recalculation) or based on any available observable market data.

The fair value of financial debt is a factor which may be characterized as "on demand" (for example, a deposit account) is not less than the amount payable "at sight", the first date on which the amount can be required for payment.

An entity shall not reclassify a financial instrument into or out of the category at fair value in profit or loss category while it is held or issued.

If after the change of intention or ability, there is no appropriate classification of investments as held to maturity, it will be reclassified as available for sale and will be remeasured at fair value and the difference between its carrying amount and fair value will be gains and losses recorded in the category.

A gain or loss resulting from a change in fair value of a financial asset or financial liability is not part of a hedging relationship must be acknowledged as follows:

(a) A gain or loss generated by a financial asset or financial liability is classified to be evaluated at fair value in profit or loss will be recognized profit loss.

(b) A gain or loss generated by a financial asset available for sale will be recognized (a) directly in equity through the statement of changes in equity (IAS 1 Presentation of Financial Statements ), except for impairment losses gains and losses and exchange differences, until the asset is derecognised, at which time the cumulative gain or loss recognized above will be recognized in equity profit or loss. However, interest calculated using the effective interest method is recognized in the income statement. Dividends for an instrument of equity available for sale are recognized in profit or loss when the entity's right to receive payment is established (IAS 18 "Revenue").

#### **Data for evaluation techniques**

A good technique for estimating the fair value of a financial instrument should incorporate observable market data on market conditions and other factors which may affect, likely, the fair value of the instrument. The fair value of a financial instrument will be based on one or more of the following factors:

(a) *the time value of money* ( interest at the rate of basic or zero risk). Basic interest rates can usually be obtained from observable government bond prices and are usually quoted in financial publications. These rates vary mostly in terms of expected cash flow data over a yield curve of interest rates for several periods of time. For practical purposes one entity may use a general rate, which is supported and available, such as LIBOR or swap rate, such as a standard rate. (Because a rate such as LIBOR interest rate risk is not zero credit risk adjustment appropriate financial instrument that is determined by its credit risk related to credit risk that a standard rate). In some countries, government bonds may be carrying very high credit risk and may not provide a stable base interest rate, the benchmark for instruments denominated in that currency. Some entities in these countries could have a better credit position and a lower rate than the government loan. In such a case, basic interest rates may be better determined with reference to interest rates for the rated bonds in the currency of that jurisdiction

(b) *Credit risk*. The effect of credit risk on fair value (first over the base interest rate for credit risk) can be extracted from observable market prices for traded instruments, instruments of credit have different characteristics or observable interest rates demanded by creditors for loans with different credit ratings.

(c) *Rates of exchange*. There are active foreign markets for most major currencies and prices that are quoted daily in financial publications.

(d) *Goods prices*. There are observable market prices for many goods.

(e) *Equity prices.* Trade price of equity instruments are observable in some markets. Based on present value techniques can be used to estimate the current market price of equity instruments for which no observable prices.

(f) *Market volatility.* Volatility rating items sold asset can be properly estimated on the basis of historical volatilities of the market or involved in using current market prices.

(g) *Prepayment risk and surrender risk.* Models of expected prepayments on financial assets and expected patterns of redemption for financial liabilities which may be redeemed by the partner can not be less than the present value of the redemption amount..

(h) *Costs of administering a financial asset or financial liability.* Administration costs can be estimated using comparisons with current fees charged by other market participants. When the administration costs of a financial asset or financial liability are significant and other market participants would have comparable costs, the issuer would take them into account when determining the fair value of that financial asset or financial liability. It is probably fair value at the start of a contractual right to future fees to be paid equal to the cost of opening for them, except when that future fees and related costs not covered by comparable market values..

### **Gains and losses**

An applied entity IAS 21 "Effects of Changes in Foreign Exchange Rates' financial assets and financial liabilities that are monetary items in accordance with IAS 21 and currency. Under IAS 21, any gains and losses on monetary assets and monetary liabilities are recognized in profit or loss. An exception is a monetary item that is designated as a hedging instrument in either a hedge of cash flows or a hedge of a net investment. In order to recognize losses and gains on foreign exchange in accordance with IAS 21, a monetary available-for-sale financial asset is treated as if it were recorded at amortized cost in foreign currency. Consequently, for such a financial asset, exchange differences resulting from changes in amortized cost are recognized as shown above. If a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in foreign currency component of those financial instruments are recognized in profit or loss.

### **The importance of assets and liabilities for financial position and performance**

An entity shall disclose information that enables users of financial statements to evaluate the importance of financial assets and liabilities position and its financial performance as follows:

Balance. Categories of financial assets and liabilities

The carrying amounts of each of these categories will be presented either in stock or in the notes:

(a) financial assets at fair value through profit or loss, indicându them separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading;

(b) investments held to maturity;

(c) loans and receivables;

(d) financial assets available for sale;

(e) The evaluation of financial liabilities at fair value through profit or loss, giving them separate (i) those designated as such upon initial recognition and (ii) those classified as held for trading;

(f) financial liabilities measured at amortized cost.

### **Financial assets or financial liabilities at fair value through profit or loss**

If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it will be present:

(a) the maximum exposure to credit risk of the loan or receivable (or group of loans or receivables) at the reporting date;

(b) the amount by which any related credit derivatives or similar instruments that reduces the maximum exposure to credit risk;

(c) the amount of change, during the period and cumulatively in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in credit risk of the financial asset determined either:

(i) the amount of change in its fair value attributable not pote changing market conditions that have resulted in market risk, either

(ii) using an alternative method which the entity believes more faithfully represents the amount of change in its fair value attributable to changes in credit risk of the asset.

(d) the change in fair value of any related credit derivatives or similar instruments held during the period and cumulatively, the designation of the loan or receivable.

**If an entity has designated a financial liability as at fair value through profit or loss, it must submit:**

(a) the amount of change, during the period and cumulatively in the fair value of financial liability attributable to changes in credit risk of that liability determined either:

(i) the amount of change in its fair value not attributable to changes in market conditions that have resulted in market risk, either

(ii) using an alternative method which the entity believes it represents its fair value that can be associated to changes in credit risk of debt

(b) the difference between the carrying amount of financial debt and the value entity, according to the contract, must be payed at maturity by the holder of the obligation.

## Conclusions

Many entities use fair value information internally to determine their overall financial position and to take decisions on financial assets and financial liabilities. They are relevant also for the many decisions taken by users of financial statements, as in other circumstances, they reflect the reasoning of the financial markets about the present value of future expected cash flows for an instrument. Information about the fair value of financial instruments which allow comparisons have essentially the same economic characteristics, without taking into account the purpose for which they are held and time or by whom they were issued or acquired. Fair values provide a neutral basis for assessing the diligence management by indicating the effects of its decisions to purchase, sale or ownership of financial assets and ownership, maintenance or financial debt relief.

When an entity does not assess a financial asset or financial liability in its balance sheet at fair value it must provide information on fair value through additional disclosures to help users to compare entities on a consistent basis.

Giving information about fair value is not asked for investments in equities and equity derivatives related to such equity instruments, where fair value can not be measured reliably. For all other financial assets and financial liabilities is reasonable to expect that fair value can be determined with sufficient reliability within the limits of appropriate and cost. Therefore, there would be no further exemption from the requirement to submit information relating to the fair value of financial assets or financial liabilities.

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