

Editorial

Fair Value Accounting and Standard Setting Implications

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The use of fair value accounting has been much debated in the accounting literature. At the heart of the debate are issues regarding the relevance and reliability of fair value information? Accounting researchers have examined the value relevance of fair value information to ascertain its correspondence with stock market information. With the advent of greater inclusion of fair value measurements in firms' financial statements in recent years, there has been great interest in fair value accounting research in academic journals. Specifically, my fair value accounting research examined controversial accounting standards such as SFAS 157 [1] *Fair Value Measurements* and SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities* [2].

With respect to SFAS 157, we extend extant research that has investigated the economic implications of these fair value disclosures during the subprime crisis [3,4]. Specifically, we examined how investors price the fair value estimates of assets as required by Statement of Financial Accounting Standards No. 157 since the financial crisis in 2008 [5]. We observed that Level 3 fair value estimates are typically priced lower than Level 1 and Level 2 fair value estimates between 2008 and 2011. However, the difference between the pricing of the different estimates reduces over time, suggesting that as market conditions stabilize in the aftermath of the 2008 financial crisis, reliability concerns about Level 3 estimates dissipated to some extent.

We also examined whether Level 3 gains affect the pricing of Level 3 estimates because managers have discretion to use Level 3 gains to manage earnings and asset values upwards. We found that differences in Level 3 gains do not lead investors to price Level 3 estimates differently. Finally, we found evidence that the pricing of the Level 1 and Level 2 fair value estimates of assets is lower for banks with lower capital adequacy [6]. Overall, our study contributes to existing research by providing further insights toward an improved understanding of the relation between valuation and fair value information.

With respect to SFAS 159, we examined the economic implications of fair value liability gains and losses arising from the adoption of Statement of Financial Accounting Standards No. 159 [7]. We found a positive correspondence between a firm's FAS 159

fair value liability gains and losses and stock returns. However, further analysis indicates that fair value gains and losses from liabilities have a negative association with future returns, suggesting investors overreact to the earnings component. This negative association is stronger for firms with low institutional ownership. Our research contributes to existing debate whether there should be an expansion of fair value measurements in financial reporting [8]. Specifically, we provide insights regarding the controversial issue of whether marking-to-market financial liabilities leads to better quality financial reporting [9,10].

Few accounting standards have been as controversial as SFAS 157 and SFAS 159. In fact, some critics viewed SFAS 157 as partially responsible for worsening the financial crisis that erupted in 2008 [11]. Supporters, on the other hand, argue that fair value accounting standards such as SFAS 157 and SFAS 159 merely reflect problems inherent in the underlying values of certain assets and that the objective of the expanded fair value disclosure increases the transparency of fair value estimates. In this respect, my research provides interesting findings that are useful to market participants, regulators and standard setters.

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