

ON THE DEFINITION OF FAIR VALUE FOR PURPOSES OF IFRS*

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Article history:

Article No. 195/2021
Received 8 April 2021
Received in revised form
15 April 2021
Accepted 22 April 2021
Available online
29 June 2021

JEL: M41, M48

Keywords:

International Financial
Reporting Standards,
Federal Accounting
Standards, fair value

Abstract

Subject. This article discusses the issue of defining the *Fair Value* concept, its similarity and identification with the concept of *Market Value*. It examines the specifics of each particular value, defines the concept of *Fair Value*, and analyzes approaches (methods) of fair value valuation, clarifies existing problems of determining fair value for the purposes of IFRS application.

Objectives. The article aims to define the notion of *Fair Value* and appropriate use in accounting, as well as explore approaches to assess fair value.

Methods. For the study, we used a comparative analysis.

Results. The article says of many inconsistencies in the valuation of fair value, starting with the lack of a clear definition of fair value in IFRS, which is actually identified with the concept of market value. It proposes a refined definition of fair value and identifies fundamental differences between fair and market values, which are based on the procedures used in their assessment.

Conclusions. Fair and market values are two different types of valuation. Fair value can be the same as market value, but only if there is an active market available. There is no single concept of *Fair Value* presented in scientific and special literature. The same approaches are used in fair (IFRS) and market (valuation standards) assessments, but the methods described for each approach are not always the same.

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The editor-in-charge of this article was Irina M. Vechkanova
The authorized translation by Irina M. Vechkanova

Please cite this article as: Gorodilov M.A., Radevich A.A. On the Definition of Fair Value for Purposes of IFRS. *Digest Finance*, 2021, vol. 26, iss. 2, pp. 148–157.
<https://doi.org/10.24891/df.26.2.148>

In some circumstances, the accounting methodology, which pursues the use of International Financial Reporting Standard (IFRS), urges to define the fair value of assets

* For the source article, please refer to: *Городилов М.А., Радевич А.А. Об определении понятия «справедливая стоимость» для целей применения МСФО // Международный бухгалтерский учет. 2021. Т. 24. № 5. С. 575–591. URL: <https://doi.org/10.24891/ia.24.5.575>*

and liabilities (for example, this is applicable for inventories accounting as set forth in new regulatory requirements). This definition may be relevant even when the provision for impairment of assets shall be accurately measured¹, being important not only for IFRS users, but also for entities preparing their financial statements under the Federal Accounting Standards (FAS), since they sometimes refer to IFRS. In the mean time, the scientific and special literature fails to offer any firm approaches to the issue, which would sufficiently unveil how the fair value shall be assessed for purposes of IFRS. The very concept of fair value is very difficult to define even from scientific and methodological perspectives.

It is still disputable whether it is reasonable to use fair value in accounting and financial reporting. Some scholars opine that the misstatement risk will grow if the standard is implemented.

Thus, according to D. Procházka, as fair value signifies the hypothetical value that currently exists in the market, and such market value cannot be directly observed all the time and checked through ordinary accounting procedures, the use of fair value for accounting can cause the overstatement of the value of assets, net assets, thus giving way to manipulations with financial statements to mislead stakeholders. There are some reasonable assumptions that financial statements, which are based on the fair value measurement, accelerated the 2007–2009 financial crisis and seriously aggravated its effect on businesses [1].

It is noteworthy that long ago Yaroslav V. Sokolov warned that the introduction of fair value into the accounting practice ... would put the end to the accounting practice² [2]. However, those who advocate the use of fair value allegedly hold that, despite being more reliable, the historical cost does not correspond to the current market data, which investors refer to, while fair-value-based accounting provides users of financial statements with more useful, relevant information, compared to the historical-cost accounting for purposes of making decisions on investment, thus synchronizing accounting and reporting with real business needs [3]. There are studies confirming the positive relation of fair-value-based accounting and the reliability of financial statements (illustrating cases of banks), which prove the utility of the analyzable concept [4].

In our opinion, IFRS 13 – Fair Value Measurement³ has some internal controversies. So, according to the interpretation of fair value as set forth in paragraph 2 thereof, fair value is emphasized to be a value based on the market situation. Therefore, both concepts may presumably be identical. Furthermore, as per subparagraph 62, B5-B11 IFRS 13, fair

¹ On the Adoption of International Financial Reporting Standards and IFRS Interpretations in the Russian Federation and the Invalidation of Some Orders (Some Clauses of the Orders) of the Ministry of Finance of the Russian Federation: International Accounting Standard 36 – Impairment of Assets: Order of the Ministry of Finance of the Russian Federation of December 28, 2015 № 217н (edition of July 11, 2016).
URL: http://www.consultant.ru/document/cons_doc_LAW_193532/ (In Russ.)

² Pyatov M.L. [Fair value: What is it?]. *BUKH.IC*, 2013, no. 8. URL: <https://buh.ru/articles/documents/15110/> (In Russ.)

³ On the Adoption of International Financial Reporting Standards and IFRS Interpretations in the Russian Federation and the Invalidation of Some Orders (Some Clauses of the Orders) of the Ministry of Finance of the Russian Federation: International Financial Reporting Standard 13 – Fair Value Measurement: order of the Ministry of Finance of the Russian Federation of December 28, 2015 № 217н (edition of July 11, 2016).
URL: http://www.consultant.ru/document/cons_doc_LAW_193532/ (In Russ.)

value can be measured through the market, replacement and net present value. That is, the market value is simply the basis (or more like one of the techniques) for fair value measurement. Hence, in the said context, the concepts of fair value and market value can no longer be considered as identical.

Scientific and special literature still provides no instructions on the correlation of fair value and market value. We should completely support T.Yu. Druzhilovskaya stating that the use of fair value measurement in the Russian accounting practice has been one of the most disputable issues from scientific and methodological perspectives for a long time [5].

As mentioned by Z.S. Tuyakova, if some reasons for recognizing the market value as fair value are considered, it will practically equate both concepts, which is not very correct, because the market value for IFRS purposes is used as the basis for fair value measurement and requires some conditions that are missing in the ordinary market [6].

N.A. Mishchikhina and N.N. Romanenko believe, the analyzable concepts do look alike, but only in certain cases. The critical difference does not lie in definitions, but stems from procedures (techniques, better to say⁴) concerning the measurement of fair value and market value as different estimates [7].

According to V.V. Kovalev and Vit.V. Kovalev, fair value shall mean a quality of an item, which determines its comparative significance in possible or actual exchange transactions, given the complete awareness of the parties, their independence and freedom of decision⁵.

As interpreted by T.N. Mal'kova, fair value is the cost for which independent and knowledgeable parties can acquire assets/extinguish liabilities⁶. The author reasonably points out the following conditions for using fair value, i.e. the existence of the active market, available information about prices, awareness and independence of parties, competent marketing, possible verification (measurement) on the part of an independent professional appraiser.

According to L.I. Khoruzhii and A.E. Vyruchaeva, fair value is not simply an estimate for purposes of the asset acquisition, performance of obligation and transactions among parties. It is a set of accounting procedures to assess the potential enterprise value. Fair value is a measure that best serves for the presentation of reliable and transparent information. It is measured by the economic-substance-over-legal-form principle [8].

In our opinion, O.V. Rozhnova offers the most complete definition of fair value. Fair value shall be understood, first of all, a measure of an accounting item, transaction value in terms of the market [9]. Looking at the subject from market perspectives, users can evaluate the economic entity, first, in terms of competition, and, second, the forecasting approach, while the market measure primarily translates market expectations about future benefits that the economic entity may derive.

⁴ Authors' comments.

⁵ Kovalev V.V., Kovalev Vit.V. *Korporativnye finansy i uchet: ponyatiya, algoritmy, pokazateli* [Corporate finance and accounting: Concepts, algorithms, indicators]. Moscow, Prospekt Publ., 2019, 992 p.

⁶ Mal'kova T.N. *Teoriya i praktika mezhdunarodnogo bukhgalterskogo ucheta* [Theory and practice of international accounting]. St. Petersburg, Biznes-prensa Publ., 2003, 345 p.

It is worth referring to proceedings analyzing fair value measurement approaches with respect to mineral resources. As T.V. Ponomarenko and I.B. Sergeev note, market value can be a substitute of fair value, as it arises from the active (plenty of sale-purchase transactions with the asset) and effective market, where all market actors have the full and equally accessible information. In the mean time, market value is not fair value, since neither market is perfect, while the economic value cannot be reliably assessed as there are no absolutely identical assets to compare with [10, p. 165].

E.V. Ignatov raises an important question about the definition of fair value in the context of the Russian economy. There is no active market where parties directly transact selling and buying licenses [11]. Hence, fair value and market value shall not be understood as one and the same concept.

Fair value is differently interpreted even across International Financial Reporting Standards. Thus, IFRS 13, IAS 16, IAS 38, IAS 2 and some other contain another definition of fair value, which we mentioned above. In the mean time, IAS 17 and IFRS 2 interpret it in a different way, like an amount for which the asset can be exchanged or liability settled between knowledgeable and willing parties in an arm length's transaction. With this in mind, there should have been given the consistent definition of the analyzable concept across the entire IFRS.

Conclusion 1. *Fair value and market value do differ, being two types of measurement. However, fair value can be equal to the market value, but only in case of the active market. If there is no active market, market value for IFRS 13 purposes cannot be reliably measured, while fair value can be assessed under certain circumstances, using other fair value measurement techniques.*

Conclusion 2. *Scientific and special literature fails to provide the uniform and consistent definition of fair value. In our opinion, the definition below would best fit the analyzable concept: fair value is the value that determines the measurement of an analyzable item in terms of quality and quantity. It can be measured given the complete knowledgeability and independence of parties in the active market.*

We compare the concepts of fair value and market value (*Table 1*), considering other conditions being equal by default:

- the seller and the buyer are very knowledgeable;
- parties make a deal by their own will, without coercion;
- parties transact on the arm length's principle.

Therefore, the above requirements of paragraph 2, IFRS 13 should have been specified. Provisions of the above paragraph, i.e. fair value is market value, should not be understood as the equality of fair value and market value, but rather as the emphasized need to assess unbiased, reasonable amount of fair value based on various valuation approaches. To avoid any discrepancies of the wording given in paragraph 2 thereof, the term *market value* should be substituted with the *unbiased value*.

Speaking about the fair value measurement technique, it is noteworthy that IFRS 13 provides rather a general description. It just states that fair value is measured through the market, cost and income approaches. Please note that IFRS 13 obviously diverges from valuation standards concerning this issue. The valuation standards provide for the comparative, cost and income approaches, while each of them includes measurement techniques.

IFRS 13 fails to specify the above methods (approaches) and their distinctions in different situations. It does not give any references either, which could contain any further details.

For example, as per paragraph 63, IFRS 13, fair value can be measured with one or multiple valuation methods. However, it provides no instructions how such fair value measurement methods should be chosen. Mentioning a multitude of fair value measurement methods, IFRS 13 emphasizes that the respective resultant fair value should fit in a range of values (called fair value measurements in IFRS), with a respective fair value measurement being a value within the above range, which best reflect fair value in the existing circumstances. While the valuation methodology requires considering interim measurements made through various approaches and(or) methods and inferring the final result (by assessing the weighted average value with reference to aspects that explain a share of each interim result from an approach and (or) method used, the analyzable IFRS does not provide for such a step. There is no technique for assessing values within a range of fair value measurements.

Therefore, the incorrect use of the concept is the first thing to criticize. In the Russian version of IFRS 13, the market, income and cost approaches are erroneously rendered as methods for fair value measurement, with each of them being subdivided into techniques. The valuation standards stipulate three approaches, i.e. the comparative, cost and income approaches, with each of them being subsequently subdivided into valuation techniques. We believe, such divergence of IFRS and valuation standards stems from unclear definitions set forth in the Russian version of IFRS 13. It would be more correct to use the terminology adequate for the valuation standards⁷.

Table 2 compares the approaches in detail as set forth in respective documents.

Having analyzed valuation approaches articulated in IFRS and the valuation standards, we noted that the same approaches are used to measure fair value (in IFRS) and market value (the valuation standards). However, methods within each approach are not always consistent. Nevertheless, both IFRS and the valuation standards allow using one or several approaches at a time to assess the fair value of an asset or a liability (explaining why the other methods were declined). As fairly mentioned by E.S. Puchkina and A.A. Rovnaya, the measurement of fair value cannot be totally unbiased by nature, since

⁷ As per the Federal Valuation Standard *General Concepts of Valuation, Approaches and Valuation Requirements* (FVS 1), approved by Order of the Ministry of Economic Development of the Russian Federation of May 20, 2015 № 297, the income approach and cost approach prevail in valuation (URL: <https://legalacts.ru/doc/prikaz-minekonomrazvitija-rossii-ot-20052015-n-297/>) (In Russ.) Choosing the suitable approach, appraisers should consider not only their applicability, but also goals and objectives of valuation, the intended use of valuation results, assumptions, completeness and reliability of input data. Analyzing the above aspects, appraisers justify a choice of approaches. We should mention that the original English version of IFRS 13 sets forth fair value measurement approaches, such as the market approach, income approach and cost approach.

the process always involves someone's personal views due to the specifics of calculations, valuation goals, the completeness of inputs, inaccuracy of techniques and other reasons [12].

The fair value of non-financial assets is another rather a disputable matter in the context of IFRS 13. As per paragraph 30 thereof, the entity should measure the fair value of the above assets, assuming that they were used in the best and most effective way by market actors, notwithstanding that the entity itself may not use such assets likewise. As per Appendix A to IFRS 13, the best and most effective use shall mean market actors use the non-financial asset in so as to increment the value of the asset or a group of assets and liabilities as much as possible (for example, business) that involves the asset.

In fact, the observance of the provision may cause the overstatement of the assets and, consequently, undermine the prudence principle. It is the drawback (in addition to complex computations, negative implications entailing financial data manipulations) that G.R. Shulenbaeva and A.S. Dzhondel'baeva emphasize in their study [13].

In the mean time, we should necessarily spotlight obvious strengths of the fair value concepts as per IFRS, i.e. the informative importance, transparency and the best compliance with the effective management principles [13].

It is worth mentioning that IFRS do not instruct what market agent can measure fair value, whether the accountant or the appraiser (both), and what circumstances should be in place. IFRS might have provided more detailed guidance on principles to follow when appointing the person responsible for fair value measurement.

Speaking about professional appraisers and their activity, we emphasize that fair value measurement approaches as per IFRS 13 completely coincide with those set forth in the International Valuation Standards (IVS). However, we can but admit that the IVS and IFRS use different denotations, referring to the same measure based on the market, cost and income approaches. The IVS call it the market value, while IFRS put it as fair value.

As explained above, fair value and market value are not synonymous. The analyzable technique relates specifically to fair value. Hence, the concept fair value should be implemented into the International Valuation Standards, harmonizing it with IFRS regulations, since these are appraisers who actively participate in the valuation for purposes of the first-time adoption of IFRS and measure fair value.

Table 1
Comparison of the concepts of *Fair Value* and *Market Value*

Comparable aspect	Fair Value	Market Value
Regulatory framework	IFRS, which can be used to prepare consolidated financial statements under IFRS and (or) keep accounting records and financial reporting under the Federal Accounting Standards	Federal Valuation Standards, which are applicable in compliance with Federal Law <i>On Valuation in the Russian Federation</i> of July 29, 1998 № 135-ФЗ [*]
Valuation approaches	A choice of an approach depends on a group the item in question pertains to and the availability of inputs about the item. The market approach is believed to be the most accurate and advisable tool (the comparative approach as per the valuation standards). However, if there is no active market or a limited market, the other approaches can be applied	The agent should apply three obligatory approaches (cost, income and comparative) or explain what one of them is declined. For example, the comparative approach implies constitutive methods, such as the regression analysis method, quotation method, etc. The income approach is based on the Discounted Cash Flow method, etc. The appraiser can use other computation methodology and choose a method (methods) to measure assets as part of the chosen approaches, adhering to principles of materiality, reasonableness, uniqueness, verifiability and sufficiency
Additional factors	All factors should be considered if they reflect benefits or implications for transaction parties	All subjective factors are disregarded, with the pure market situation being the main focus
Correlation of the concepts	The concept fair value seems broader in comparison with market value. The latter may coincide with fair value, but only under certain circumstances	Fair value does not always coincides with market value

^{*} Federal Law *On Valuation in the Russian Federation* of July 29, 1998 № 135-ФЗ (the latest edition).
 URL: http://www.consultant.ru/document/cons_doc_LAW_19586/ (In Russ.)

^{**} Authors' comments.

Source: Authoring

Table 2
Description of the approaches to assessing fair (IFRS) and market (VS) values

Approaches	IFRS 13	Federal Valuation Standard 1
Market approach (comparative)	The market approach refers to prices and other relevant information about deals that take place in the market with identical or comparable (that is, similar) assets, liabilities or a group of assets and liabilities, such as business. The market multipliers, matrix method are applied	The comparative approach is a set of valuation methods based on the measurement of an appraisal item by comparing the appraisal item and identical items. The comparative approach is advisable when there is reliable and sufficient information to analyze prices and qualities of identical items. It is allowed to refer to prices of the completed transactions and asking prices. The comparative approach provides for various methods that directly compare the appraisal item and identical items, and methods that analyze statistical data and information about the market where the appraisal item exists
Income approach	The income approach transforms future amounts (for example, cash flows or income and expenses) into the current value, that is the discounted one. As part of the income approach, fair value measurement reflects the current market expectations about the said future amounts. The income approach includes methods that assess the net present value, use the option pricing model, the multiperiod model of surplus profit	The income approach is a set of valuation methods that determine the expected income from the use of the appraisal item. The income approach is advisable when there is reliable information to forecast the future income, which the appraisal item can generate, and respective expenses. The income approach involves various methods based on cash flow discounting and income capitalization
Cost approach	The cost approach infers the amount, which would be needed at the moment to replace the operating capacity of the asset (it is often called the current replacement cost)	The cost approach is a set of valuation methods that assess expenses to acquire, reproduce or replace the appraisal item with respect to wear and tear. The cost method is primarily applied when there is reliable information to assess costs for acquisition, reproduction or replacement of the appraisal item. The cost approach includes various methods that assess costs for production of a replica of the appraisal item or the item with similar utility

Source: Authoring

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(In Russ.)

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