

Standard-Setters, Measurement Issues, and the Relevance of Research

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Standard-Setters, Measurement Issues, and the Relevance of Research

1. Introduction

Measurement is a key aspect of financial reporting. This paper explains how standard-setters approach measurement, the measurement bases that they commonly consider, and how research can contribute to resolving standard-setting issues related to measurement.

Standard-setters approach measurement issues in the same way as they approach other standard-setting questions. That is, they attempt to apply their conceptual framework. The International Accounting Standards Board's (IASB) conceptual framework is specified in its *Framework for the Preparation and Presentation of financial Statements (Framework, IASCB, 1989)*. The conceptual framework of the U.S. standard-setter, the Financial Accounting Standards Board (FASB), specified in *Statements of Financial Accounting Concepts (SFAC) Nos. 1, 2, and 5 – 7 (FASB, 1978, 1980, 1985, 1985, and 2000)*.¹ Despite its importance, measurement has received relatively little attention in the conceptual frameworks of financial reporting standard-setters. Thus, in making measurement decisions, standard-setters focus on applying the definitions of financial statement elements and the qualitative characteristics of accounting information in the context of the objective of financial reporting.

Application of those concepts has resulted in a variety of measurement bases being used to measure financial statement amounts. These include historical cost, amortized historical cost, fair value, and value in use, among others.² Each basis has advantages and disadvantages

¹ The IASB and FASB conceptual frameworks are similar, but not identical. Thus, the two boards currently have a joint project to complete, converge, and improve their conceptual frameworks. Because the boards anticipate that the framework project will take many years to complete, they are conducting it in phases. Measurement is one of the phases.

² Some advocate the use of deprival value as a measurement basis. Deprival value is the loss that the entity would suffer if it were deprived of the asset. It is measured as the lower of replacement cost and recoverable amount, where recoverable amount is the higher of value-in-use and net realizable value. IASB (2005), prepared by the staff

relative to the others in meeting the conceptual framework criteria. However, a review of the recent activities of the IASB and FASB reveals that the use of fair value in financial reporting is likely to increase. This is because as the boards have debated particular measurement questions, they have concluded that fair value meets the conceptual framework criteria better than other measurement bases considered. It is not because the boards have a stated objective of changing accounting measurement to fair value for all assets and liabilities. However, fair value is not a panacea and other measurement bases also have desirable characteristics. Thus, which basis standard-setters will require in any particular situation is not a foregone conclusion.

Research can be helpful to standard-setting debates about measurement. This is because research is generally rigorously crafted and grounded in economic theory. Also, because academics do not have a vested interest in the outcome of the research, research typically is unbiased. Relating specifically to measurement, research can provide insights into how alternative measurement bases, in a variety of contexts, meet the criteria in the conceptual framework, such as relevance and faithful representation, formerly termed reliability. Researchers also can question the current framework by rethinking the objective and characteristics of financial reporting and, if necessary, offering an alternative framework that comprehensively meets the objective and evidences the desired characteristics. Research also can identify measurement alternatives to fair value that can be used on a comprehensive basis. Relating to fair value measurements themselves, research can help link valuation theories to the real world in which we live. Such research would aid standard-setters, for example, in determining which assumptions underlying the theory are most important and which ones can be ignored. For example, most valuation theory relies on perfect and complete markets – or at least

of the Canadian Accounting Standards Board (CASB) explains that deprival value is a decision rule for determining which of these measurement bases to use.

no arbitrage markets. Without these market features, a single value for every asset and liability does not exist. But, by how much does the extent of inconsistency with each of these assumptions that we observe affect the resulting values? Is it enough to be concerned about from a practical perspective? There is much to learn about accounting measurement and research can aid standard-setters in identifying the issues they need to address, helping them structure their thinking about the issues, and providing evidence that informs the debate about the issues.

The paper proceeds as follows. Section 2 explains how standard-setters approach measurement, and dispels some common misunderstandings. Section 3 discusses why standard-setters focus on fair value and identifies some of the possible alternatives. Section 4 suggests some ways in which research can inform standard-setting relating to measurement issues. Section 5 offers concluding remarks.

2. How do standard-setters approach measurement?

2.1 Conceptual framework

As with any standard-setting decision, when making decisions relating to accounting measurement, the IASB strives to follow its *Framework*. Unfortunately, the current *Framework* does not include much guidance on measurement. It simply lists examples of measurement bases and measurement techniques that are currently used in financial statements. It does not identify their key attributes or provide criteria for selecting among them. Thus, when applying the *Framework* to measurement questions, the IASB focuses on determining which measurement basis best meets the objective of financial reporting, the elements definitions, and the qualitative characteristics of accounting information. The treatment of measurement in the FASB's conceptual framework, specifically SFAC 5, is similar to that in the IASB's *Framework*. Thus,

the present joint IASB/FASB conceptual framework project includes a separate phase on measurement aimed at developing concepts relating to measurement in financial reporting.³

The objective of financial reporting is “to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions.” (IASB, 2006a, ¶OB2).⁴ The term “investors” refers to present and potential equity holders and their advisers, and the term “creditors” refers to present and potential lenders and their advisers. The resource allocation decisions of these users include determining whether to buy, sell, or hold equity securities and whether to lend funds to or call existing debt issued by the entity. Although investors, particularly, and creditors are interested in estimating the value of the entity’s equity, it is not the objective of financial reporting to provide such estimates. Rather, the objective of financial reporting is on the information needs of a wide range of users in making a wide range of economic decisions, which are not limited to those dependent on estimates of equity value.

The objective of financial reporting focuses on these users based on the belief that meeting their needs will meet the needs of other financial statement users. For example, as the preliminary views document points out, consistent with the current IASB *Framework*, “users of financial reports wishing to assess how well management has discharged its stewardship responsibilities are generally interested in making resource allocation decisions... Decisions

³ At the request of the IASB, the staff of the CASB analyzed the characteristics of alternative measurement attributes and issued a discussion paper to invite comments on its analysis. The CASB staff concluded that fair value should be the measurement attribute for initial recognition for all assets and liabilities (IASB, 2006). Comments received on the discussion paper will inform the measurement phase of the joint IASB/FASB conceptual framework project.

⁴ At the present time, the first two chapters of the converged framework, comprising the first phase, have been exposed as a preliminary views document for public comment. Those two chapters cover the objective of financial reporting and the qualitative characteristics of accounting information. Because the boards believe that the proposals relating to the objective of financial reporting and the qualitative characteristics of accounting information represent clarification of the current frameworks, not conceptual changes, this paper will use the proposed revised and clarified wording when discussing objective of financial reporting and the qualitative characteristics of accounting information. Much of the discussion in this section is taken directly from the preliminary views document (IASB, 2006a).

about whether to replace or reappoint management, how to remunerate management, and how to vote on shareholder proposals about management's policies and other matters are also potential considerations in making resource allocation decisions..." (IASB, 2006a, ¶OB28). The objective of financial reporting affects measurement decisions because it establishes the context for assessing the qualitative characteristics of accounting information, including accounting measurements.

The qualitative characteristics of accounting information are relevance, faithful representation, comparability, and understandability. Relevant information is capable of making a difference to a financial statement user's decisions. Relevant information has predictive value, i.e., it helps users to evaluate the potential effects of past, present, or future transactions or other events on future cash flows, and confirmatory value, i.e., it helps to confirm or correct their previous evaluations. Making the information available to users before it loses its capacity to influence their decisions, i.e., timeliness, is another aspect of relevance. Faithful representation means that the information reflects the real-world economic phenomena that it purports to represent. Real-world economic phenomena are economic resources and obligations and the transactions or other events that change them. Accounting constructs that are the creation of accountants, such as deferred charges, are not real-world economic phenomena. Neither are results of calculations, in themselves. Components of faithful representation include verifiability, i.e., different knowledgeable and independent observers would reach general consensus, neutrality, i.e., freedom from bias intended to attain a predetermined result or to induce a particular behavior, and completeness, i.e., it includes all of the information that is necessary for a faithful representation.

As the preliminary views document explains, the qualitative characteristics are subject to two pervasive constraints, materiality and benefits that justify the costs. Information is material if its omission or misstatement could influence the resource allocation decisions that users make. It is a pervasive constraint on the information to be included in an entity's financial report rather than a qualitative characteristic of accounting information. The benefits of financial reporting information include better investment, credit, and similar resource allocation decisions, which in turn result in more efficient functioning of the capital markets and lower costs of capital for the economy as a whole. Costs include direct and indirect costs incurred by both preparers and users of financial statement information, as well as by auditors and regulators. Assessing whether the benefits exceed the costs is inherently subjective because it is not possible to obtain quantitative data on all costs and benefits. However, the requirement to assess benefits and costs means that standard-setters need to consider practicality as well as concepts.

Comparability, which includes consistency, is the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena. Consistency helps achieve comparability because it refers to the use of the same accounting policies, either from period to period within an entity or in a single period across entities. Understandability is the quality of information that enables users who have a reasonable knowledge of business and economic activities and financial reporting, and who study the information with reasonable diligence, to comprehend its meaning.

When making measurement decisions, standard-setters also take into consideration the *Framework* definitions of assets and liabilities:

An *asset* is a resource controlled by the entity as a result of past transactions and events and from which future economic benefits are expected to flow to the entity.

A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

These definitions specify the real-world economic phenomena that accounting should measure.

2.2 Common misunderstandings

There are several common misunderstandings about how standard-setters approach measurement decisions.⁵ First, conservatism is not a qualitative characteristic of decision-useful financial information. Conservative amounts are not neutral, which is a qualitative characteristic. As noted in section 2.1, neutrality means freedom from bias. Conservatism implies a negative bias for assets and income and a positive bias for liabilities and expenses.⁶ Second, matching is not a separate concept in the *Framework*. This is because matching is not an objective of accounting measurement, per se. Rather, it is an outcome of applying the other concepts. That is, the *Framework* is based on the notion that if assets and liabilities are appropriately recognized and measured, income will be too, which obviates the need for a separate concept of matching.⁷

Third, the term reliability as used in the current *Framework* is neither limited to verifiability, as some interpret it, nor does it mean precision. It means faithful representation of the real-world economic phenomenon it purports to represent. This common misunderstanding is why the preliminary views document (IASB, 2006a) uses the term “faithful representation” rather than “reliability” and explains that just because a measure can be precise, it is not necessarily a faithful representation of the real-world economic phenomenon it purports to

⁵ See Storey and Storey (1998) for a history of some of these misunderstandings in the context of the development of the FASB conceptual framework.

⁶ See IASB (2006a, ¶BC 2.19 to BC2.22). Also, if conservatism were a desirable qualitative characteristic, the *Framework* would need to specify how conservative financial reporting should be. This is not possible without much specifying all users’ objective functions, which is not feasible.

⁷ The existing *Framework* (IASCB, 1989 ¶95) discusses the concept of matching income and expenses. However, the discussion ends by stating “However, the application of the matching concept under this *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.” Thus, matching per se cannot be used to justify income or expense recognition that is inconsistent with the definitions of assets and liabilities.

represent. Faithful representation implies neither absolute precision in the estimate nor certainty about the outcome. Fourth, the objective of financial reporting does not include providing accounting information for management to use in managing the business or for contracting parties to include in contracts. This is because these users can directly specify the measures they want and need. The IASB and FASB standards are designed for general purpose financial reports, whose objective stems from the information needs of external users who lack the ability to prescribe all the financial information they need from the entity. This is not to say that measures used for financial reporting are not useful for managing the business or contracting purposes. But, if they are, this is a by-product, not an objective, of external general purpose financial reports.

Fifth, the *Framework* focuses on defining financial position elements, i.e., assets and liabilities, not because financial position is more important than income. Rather, it is because income is important and defining financial position elements is the only way standard setters have been able to determine how to measure income. To date, attempts to define income without reference to assets and liabilities have been unsuccessful. This approach also is consistent with the concept of income being the change in wealth during the period (Hicks, 1946). Sixth, the IASB and FASB do not have as an objective to measure all assets and liabilities at fair value. As explained in section 3, there are reasons why fair value is a candidate measurement basis in many situations, and the IASB and FASB have a stated long-term objective to measure all financial assets and liabilities at fair value. However, there is no similar objective to measure other assets and liabilities at fair value.

3. Which measurement basis?

3.1 Fair value

Observation of the IASB and FASB standard-setting reveals that they consider fair value as a possible measurement basis in many situations. A primary reason for this is that the *Framework* criteria make fair value a natural measurement basis to consider. First, fair values are relevant because they reflect present economic conditions relating to economic resources and obligations, i.e., the conditions under which financial statement users will make their decisions.⁸ Fair values also have predictive value.⁹ Second, fair values can be faithful representations of assets and liabilities, as defined in the *Framework* because they reflect risk and probability-weighted assessments of expected future inflows and outflows. Fair values are unbiased and, thus, neutral. Fair values are timely because they reflect changes in economic conditions when those conditions change.¹⁰ Third, fair values are comparable because the fair value of any particular asset or liability depends only on the characteristics of the asset or liability, not the characteristics of the entity that holds the asset or liability or when it was acquired. Fair values enhance consistency because they reflect the same type of information in every period.¹¹

Despite these advantages, fair value measurement is not a panacea. Some commonly expressed concerns include lack of a clear definition of fair value, lack of verifiability, the ability for management to affect fair value estimates, and the potential circularity of reflecting fair values in financial statements when the objective is to provide financial statement users with information to make economic decisions that include assessing the value of the firm.

⁸ See Barth, Beaver, and Landsman (2001), Landsman (2005), Barth (2006b), and Landsman (2006) for summaries of the empirical research relating to the value relevance of fair values. Finding that fair values are value relevant indicates they are relevant and sufficiently representationally faithful to be included in investors' equity valuation assessments.

⁹ See, e.g., Barth, Landsman, and Wahlen (1995) and Aboody, Barth, and Kasznik (1999).

¹⁰ See, e.g., Barth, Beaver, and Landsman (1996), Barth, Clement, Foster, and Kasznik (1998), and Aboody, Barth, and Kasznik (1999).

¹¹ For more discussion, see Barth (2006a) and IASB (2005).

The IASB defines fair value as “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction” (IAS 39 ¶9; IASB, 2004). Although this definition states the measurement objective, it lacks sufficient specificity to ensure consistent application. Because of similar problems in US accounting standards, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157 (FASB, 2006), which specifies how to estimate fair value. The IASB has a project on its agenda to develop a similar document.¹² Thus, the present concerns about lack of specificity are valid, at least for entities applying international accounting standards; SFAS 157 has mitigated these concerns for entities applying US standards.

Verifiability is a component of faithful representation. The concern over verifiability of fair value often is expressed in relation to assets and liabilities that do not have observable market prices. For such assets and liabilities, fair value must be estimated, which raises the possibility that the estimates will not be verifiable. As explained in section 2.1, information is verifiable if different knowledgeable and independent observers would reach general consensus, although not necessarily complete agreement. IASB (2006a) explains that verification can be direct or indirect. Indirect verification involves determining whether the measurement method has been applied without material error or bias, and relies on verifying the inputs to the measurement method. Direct verification relies on verifying the measurement itself. Thus, fair values may not be verifiable in some situations if many inputs to the measurement method are not verifiable.

The effect of management incentives on fair value estimates is also of concern primarily when observable market prices are unavailable. The fact that fair value estimates incorporate

¹² The IASB plans to issue SFAS 157 as a discussion document as the first step in its fair value measurements project.

and, thus, reflect managers' detailed information that is not necessarily available to others is a desirable aspect of fair value. Reflecting such information in financial statements mitigates that need for market participants to come up with noisy estimates based only on public information. Nonetheless, the concern about the effects of management incentives is valid. However, this is not unique to fair value. A large body of research shows that managers find ways to manage earnings regardless of the accounting regime.¹³ Whether this is a greater potential problem for fair values than for other accounting estimates is an open empirical question (see, e.g., Landsman, 2006).

Finally, it is unlikely that even if all recognized assets and liabilities were measured at fair value, recognized equity would equal the market value of equity. This is because only assets and liabilities that meet the *Framework* definitions are candidates for recognition. Market value of equity reflects investors' assessments of, among other things, growth options and managerial skill that do not meet the asset definitions. Also, in most cases, the market envisioned when estimating fair value for individual assets and liabilities is not the market for the entity's equity. However, in some cases, such as major business combinations or for single reporting unit entities, it could be.

Another reason that standard-setters consider fair value in most measurement situations is that its use holds promise for minimizing the undesirable effects of the mixed measurement approach to financial reporting that we have today. Presently, financial statement amounts are determined using a variety of measurement bases. These include, for example, historical cost (used for cash), amortized historical cost (used for loans receivable and long-term debt), impaired amortized historical cost (used for purchased property, plant, and equipment), accumulated amortized and impaired historical cost (used for self-constructed property, plant,

¹³ See, e.g., Healy and Wahlen (1999) for a review of this literature.

and equipment), fair value (used for derivatives and asset revaluations), and entity-specific value (used for impaired inventories and impaired property, plant, and equipment).¹⁴ These differences in measurement bases do not result from differences specified in the *Framework*. Rather, they result from conventions and differences in practice that have evolved over time. Thus, when viewed in terms of the *Framework*, these differences generate financial statements that are internally inconsistent. Not only is use of multiple measurement bases conceptually unappealing, it creates difficulties for financial statement users. Measuring financial statement amounts in different ways complicates the interpretation of accounting summary amounts such as net income. Using multiple measurement bases makes it difficult for financial statement users to separate accounting-induced income or expense from economic income or expense (see, e.g., Barth, 2004). Thus, fair value applied comprehensively has appeal.¹⁵

3.2 Alternatives to fair value

Although opponents of more comprehensive use of fair value have some legitimate concerns, standard-setters are unaware of a plausible alternative. Some opponents advocate historical cost. However, we do not comprehensively use historical cost in financial statements today. Items initially recognized at cost typically are subsequently measured at amortized and impaired amounts; these are not historical cost. Thus, one would need to specify how these items should be measured subsequent to initial recognition. Also, it is unclear whether historical cost has the qualitative characteristics of accounting information specified in the *Framework*.

For example, although historical cost is a real-world economic phenomenon and, thus, an

¹⁴ The IASB and FASB staff on the Measurement phase of the joint Conceptual Framework project has tabulated the different measurement methods currently used in IASB and FASB standards. The list contains a large number of methods. For many of the methods, there is no obvious reason for the differences from other methods. This observation makes clear the need to rationalize the methods we use.

¹⁵ Until and unless fair value is used for all assets and liabilities, the mixed measurement approach will persist. Even then, issues related to cash flow hedges remain. However, the more consistently we measure assets and liabilities, the less the mixed measurement approach is a problem.

historical cost measure can be a faithful representation, historical cost may not be a relevant economic phenomenon for users making economic decisions. Also, the present convention of recognizing decreases in asset values, i.e., impairments, but not increases in asset values, is inconsistent with neutrality. Moreover, some assets and liabilities have no cost – notably derivatives. This raises the question of how such assets and liabilities would be reflected in historical cost financial statements without either leaving them unrecognized or creating a mixed measurement approach.

Value in use, or entity-specific value, is another possible measurement alternative. Value in use requires including future cash flows that the entity expects to receive, discounted at a rate that reflects the entity's cost of capital, even if these differ from those of other entities.¹⁶ Thus, entity-specific value differs from fair value in that entity-specific value includes cash inflows or outflows expected by the entity that would not be expected by other market participants, such as expected inflows related to superior management talent.¹⁷ As with all measurement bases, measuring assets and liabilities at entity-specific value also has implications for income measurement. Because entity-specific value measures assets and liabilities based on what the entity expects to accomplish with the assets, the value of the entity's special rights or skills are recognized when the assets are recognized, not when the entity realizes the benefits associated with those special rights or skills. Thus, income resulting from using entity-specific value for asset and liability measurement would reflect how the entity performed during the period given its own plans and special rights or skills. In contrast, using fair value would result in income reflecting how the entity performed during the period given the assets at its disposal relative to

¹⁶The IASB defines entity-specific value as “the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability” (IASB Glossary of Terms, IASB 2006b).

¹⁷ See SFAS 157 (FASB, 2006) for further discussion.

other market participants' expected performance. If the entity makes better use of the assets, income will be greater than the return expected based on the riskiness of its net assets; if it makes worse use of the assets, income will be less than the expected return.¹⁸

It could be possible to decouple financial position measurement from income measurement. This would eliminate the need to consider the income effects associated with a particular asset and liability measurement basis. However, to date, standard setters have been unsuccessful in developing concepts about how this would be done. Thus, those advocating this approach need to provide a conceptual basis for doing so.

There could be other alternatives that standard-setters should consider. They are open to ideas. However, before adopting one of those ideas, standard-setters need to understand the conceptual basis for the idea and how it is applied comprehensively in financial reporting.

4. How can research contribute?

Measurement is key to financial reporting. Thus, it is important that standard-setters base their decisions relating to measurement on the best possible information. It is well-known that research cannot directly answer standard-setting questions (see, e.g., Gonedes and Dopuch, 1974). Thus, some believe that research cannot be relevant to standard-setting issues. This is because accounting standards are public goods, any single research study cannot determine what the requirements of any particular standard should be. Only standard setters can make the social welfare trade-offs necessary to make that determination. Others believe that despite this, research can provide insights into standard-setting issues by operationalizing criteria standard

¹⁸ Using historical cost for all assets would reflect how the entity performed given the cost of its assets. Using a mixed measurement model, as we do presently, reflects a mixed view of entity performance, with unclear interpretation. The interpretation of income is also affected by which assets and liabilities are recognized. The amounts recognized for individual assets and liabilities do not necessarily reflect all sources of expected inflows or outflows of the entity's economic benefits. A notable example is internally generated intangible assets. Thus, income in a given period also includes cash flows associated with unrecognized assets and liabilities, as well as unrecognized but expected future transactions. See Barth (2006a).

setters establish for deciding among alternatives when developing standards, such as relevance and faithful representation. Because these criteria are specified in the conceptual frameworks of the FASB and IASB, e.g., relevance and faithful representation, there is no need for researchers to specify the objective functions of standard setters. Standard setters are potentially interested in research because they actively seek input on all of the issues they consider; research can be particularly helpful because it is unbiased, rigorously crafted, and grounded in economic theory.¹⁹ Thus, research can aid standard-setters in identifying issues, helping them structure their thinking about a particular issue, and providing evidence that informs the debate about the issue (see Barth, 2006b for more complete discussion and for examples of research that does this; see, also, Landsman, 2006).

Relating specifically to accounting measurement, research can provide insights into whether and the extent to which various measurement bases, in various contexts, meet the qualitative characteristics of accounting information specified in the current *Framework*. It also can help determine which real-world economic phenomena are relevant to financial statement users. There is a large body of financial accounting research, particularly capital markets research, described as adopting a measurement perspective (Beaver, 1998) that does this; more is needed.²⁰ Because faithful representation is a key concern for any measurement, and no representation is perfect, research providing insights into how faithful is faithful “enough” would be helpful. Such research aids standard setters in making measurement decisions in the context of their own criteria.

¹⁹ See Holthausen and Watts (2001) and Barth, Beaver, and Landsman (2001) for alternative perspectives on these issues.

²⁰ See, e.g., Landsman (1986), Barth (1991), Choi, Collins, and Johnson (1997). See also Barth (2006b) for further discussion and more examples.

Research also can explore comprehensive financial reporting measurement alternatives to fair value. As noted above, many have concerns with using fair value as the measurement basis in many situations but there is no clear alternative under consideration. Standard setters would like to understand why the alternative is better in terms of meeting the objective of financial reporting and the qualitative characteristics of accounting information. They also would like to understand how the alternative would apply to various types of assets and liabilities and what it implies for income measurement.

Fair value is a measurement basis for assets and liabilities that do not have observed market prices. Thus, standard setters would find helpful research that relates valuation theory to the imperfect and incomplete world in which we live. Accountants need to become more comfortable with valuation theories, techniques, and practicalities. Simply saying that valuation theory does not fit all aspects of the real world is not helpful. What would be helpful is research into how the differences between the assumptions underlying the theory and the real world can be addressed. Such research would highlight where the problems arise, identify which failed assumptions are most important and which can safely be ignored, and provide insights into how standard setters should think about dealing with them.

Research also can suggest alternatives to the current *Framework*. Researchers could use economic and finance theory to aid standard setters in rethinking financial reporting and, thus, the criteria in the *Framework*. This would include suggesting changes to the objective of financial reporting, the qualitative characteristics of accounting information, and the elements definitions that comprise an alternative financial reporting regime. Researchers are perhaps the best persons to do this because it is a conceptual exercise that requires new thinking that is not hampered by past practices.

5. Conclusion

Many standard-setting decisions relate to accounting measurement. Standard-setters base their measurement decisions on their conceptual frameworks. Unfortunately, the present frameworks contain virtually no guidance on measurement. The IASB and FASB are presently conducting a joint project to complete, converge, and improve their conceptual frameworks. One phase of that project is devoted to measurement. However, until that phase is complete, standard-setters must continue to base their decisions on the definitions of assets and liabilities and their assessment of the qualitative characteristics of accounting information, in the context of the objective of financial reporting. The lack of guidance specific to measurement in the conceptual framework means that measurement issues are likely to continue to be difficult to resolve. Because measurement is key to financial reporting, the issues are likely to be controversial as well.

Observation of the IASB and FASB standard setting reveals that the use of fair value as a measurement basis is likely to increase. This is because as the boards have debated particular measurement questions, they have concluded that fair value meets the conceptual framework criteria better than other measurement bases considered. It is not because the boards have a stated objective of changing accounting measurement to fair value for all assets and liabilities. However, fair value is not a panacea and other measurement bases also have desirable characteristics. Thus, which basis standard-setters will require in any particular situation is not a foregone conclusion.

Researchers can help standard-setters resolve these issues at the conceptual and practical levels. Research is particularly valuable to standard-setters because it is unbiased, rigorously crafted, and grounded in economic theory, like the conceptual framework. It can aid standard-

setters by identifying issues they need to address related to measurement issues, helping structure their thinking related to those issues, and providing evidence that informs their debate about the issues. Relating specifically to fair value as a measurement basis, research can provide more evidence on the extent to which fair value meets the criteria specified in the *Framework*. It also can help relate valuation theory to accounting measurement in the incomplete and imperfect world in which we prepare financial reports. The time has come to resolve measurement issues in financial reporting.

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