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The Impact of Fair Value Measurements on Income Statement: IFRS 13 "an Application Study in Insurance Companies"

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Abstract
There has been a steady shift in accounting standards over the past few years, moving away from historical cost measure towards fair value. Proponents view this as a way to deal with traditional criticisms of accounting valuation while making information more relevant to users. This paper attempts to shed some light on this issue by restating some of the financial assets of an insurance company, applying fair value instead of historical-cost-based valuations, and comparing data emerged by using historical costs principle and fair value principle. We find that the numbers on the face of the income statement change considerably and observe that the magnitude of these changes varies between the two policies. However, these findings seem to indicate that a change from historical-cost to fair-value accounting could achieve different results.
Key words: Fair value, Historical cost, comprehensive income.

Introduction:

The point of using fair value measure is to allow accounting to provide information that is both useful and relevant (Rankin & others, 2012). Traditionally accounting has mostly used a valuation concept known as modified historical costs as the key measurement foundation. In other words, IFRS requires that companies account for and report many assets and liabilities on the basis of acquisition price (Kieso & others, 2011). IFRS has increasingly called for use of fair value measurements in the financial statements. Fair value information may be more useful than historical cost for certain types of assets and liabilities and in certain industries. (Kieso & others, 2011).

The importance of the study:

Fair value accounting or measures or estimates often provide more of the relevant information about the future expected cash flows associated to an asset or a liability.

Using the fair value as a basis for measuring the financial assets and financial liabilities is more relevant than historical cost in these situations because it reflects the current cash equivalent value of financial instruments.

The importance of this study arises by restate income statement for the company under study by using the two principles; historical cost principle and fair value principle. This will show advantages by restate income statement, which will reflect the future expected cash flows by using fair value.

The objectives of the study:

The researcher aims at fulfilling the following goals:

1. Determine net income and comprehensive income for the company under study by using historical cost principle and fair value principle**.**
2. Obtain a broad overview about the factors which effect with net income and comprehensive income.

The problem of the study:

From the previous points, the problem of the study can be summed up as follows:

1. Is there a difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle?
2. Is there a difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle?

The study hypotheses:

The researcher tries to test if these hypotheses are correct:

H1: There is a significant difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle.

H2: There is a significant difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle.

The methodology of the study:

The researcher has adopted the descriptive application methodology because it suits the objectives of this study. The researcher has also depended on information resources relating to the study and has analyzed it.

Limits of the study:

The study includes many limits as follows:

1. The study limited only to income statement.
2. The study limited only to some financial instruments.

Previous studies:

1. Cathy A. Beaudoin and Susan B. Hughes (2014)

APT, Inc., a wholly owned subsidiary of a Canadian publicly owned company that reports using International Financial Reporting Standards (IFRS), owns a student rental complex on land leased from a U.S. university. APT, Inc.'s Director of Accounting must determine whether the apartment complex is impaired and determine the fair value of the property for financial statement disclosure purposes. As such, both he and the students assigned the case must rely on the guidance included in International Accounting Standards (IAS) 36, 40, and IFRS 13. Unlike most impairment examples included in textbooks, students are not provided with either fair value or value in use information. Rather, they must estimate the higher of the fair value less costs of disposal or value in use based upon information provided in the case. Thus, students are required to apply higher-order learning skills as they grapple with numerous decisions (e.g., discount rates, cash flow projections, relevant comparable properties and their recent selling prices). Master of Accountancy and M.B.A. students who used the case report it improves their understanding of impairment and fair value techniques. Overall, students reported they found the case a valuable learning experience, and that the case increased the extent they thought about the complexities of impairment and fair value issues.

2. Christopher L. Brown, Samanta Thapa (2013)

This study showed that during the financial crisis 2008-2009, there has been considerable debate among academics, companies and decision-makers about what respect to measurement and reporting of the fair value of the assets and liabilities in the financial statements. Provided FAS 157, which was adopted in September 2006, has laid down the rules for the measurement and reporting of fair values. The study showed that the fair value measurement problems arise during difficult times such as the global financial crisis 2008-2009. Where he then became the recorded value of the assets are not in line with its fair value. Under pressure from the banking industry, the study showed that the Financial Accounting Standards Board was changed the method of measuring the fair value of giving greater flexibility to companies in determining the fair value of assets and liabilities when the market is not active, and also allows to keep the banks from some of the losses. These changes in the fair value accounting allowed companies to use personal judgment dramatically when measuring the fair value of the assets in case the market is not active. The study was aimed to investigate the effect of changes in the fair value Financial institutions and financial asset prices. Results of the study showed that there was an actual effect of the issuance of the fair value of the modified on April 9, 2009, the shares prices of financial institutions.

3. Can Tansel Kaya, (2013)

The study showed that many of the participants in the market led to the questioning of the fair value measurement accuracy during the recent financial crisis, which led to a series of bank failures and the collapse of the stock, where the study showed that in addition to aspects related to fair value measurement shortcomings, the lack of adequate control the application of these standards, especially within the levels 2 and 3. The study also showed that the most important weaknesses in the fair value accounting is the recognition of gains and losses realized without actually in the form of unrealized gains or losses, which distort the fact of the financial situation for the owners. Thus, the above-mentioned recognition transactions unrealized will lead to the moral basis of the environment accounting vibration result in the adoption of the dubious figures, which eventually led to the agency that are inconsistent with the overall organizational goals problems by working on grants incentives is due originally which will effect on the credit rating of these institutions, which are already under the spotlight. The study showed that the Financial Accounting Standards Board and the International Accounting Standards Board have to work on reducing the gap between them so that work to give adequate attention to the issues surrounding fair value

4. Laurens Swinkels (2011)

This study showed that the basic principles which are the basis of financial reporting is based on the standard (IAS 19) and standard (RJ 271) in the Netherlands; where should determine pension obligations using the fair value Of pension assets, Where the market prices are in most cases is considered fair values. Despite the fact that in some countries are relatively active in retirement, it is still difficult to get a fair pension value, and therefore the fair value of the pension in the Netherlands.
This study attempts to answer whether there is a possibility to measure the fair value of the obligations of corporate pension. Especially in light of the evolution of discount rates over the past years. Especially during times of financial turmoil, and the differences in discount rates for companies and pension funds can be large, even exceeding 2 per cent. This leads to a pension liability of more than 30 per cent assess differences. This article also aims to compare the local pension accounting standards with international standards through the use of fair value, in principle, to evaluate the pension obligations.

Fair-value accounting:

The fair value defined by many researchers and economists as "the amount that can be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction." Therefore, the fair value is based on market mechanisms scale, and therefore the market price on the date of the event. IASB has also developed the fair value of the series, which shows the reporting of assessment methods to be used to determine fair value, so this series includes three levels, based on the first level on the related fair value on the input measures to reflect the price of assets or liabilities of conformity in active markets. As for the second level, it is based on input measures other than quoted prices within the first level, but this can be corroborated with data that can be observed. The third level, it is based on the fair value of the unobservable inputs (such as the company's own assumptions or data). Thus, the first level is considered the most reliable because it is based on quoted prices in markets and the best evidence of fair value measurement is to shut down the stock in the stock market price. The second level is the next most reliable and will depend on the evaluation of identical assets or liabilities in active markets. Or for the third level (less reliable), there is a need for a lot of judgment, based on the best available information, to get to the fair value measurement of relevant and reliable (Rankin & others, 2012) and (Kieso & others, 2011).

Under IFRS, fair values are most frequently used for financial assets and liabilities. But even for financial assets and liabilities, there is a mixed attribute model with a multitude of rules stipulating that some items are reported at fair value and others are reported at historical cost. Moreover, unrealized gains and losses of items that are reported at fair value may or may not affect net income, depending on their classification. Few dispute that transparency is important. Proponents argue that fair values for assets or liabilities reflect current market conditions and hence provide timely information, thereby increasing transparency and encouraging prompt corrective actions (Nicolae Traian Cristin, Pepi Mitică, 2013).

In the accounting literature the choice between fair value and historical cost accounting is one of the most widely debated issues. While the debate dates back to the 1990s it is still unsettled (Nicolae Traian Cristin, Pepi Mitică, 2013). Therefore, managers have stronger incentives to respond to market demands and commit to the accounting treatment that maximizes the value of the firm.

The following disclosures are required according to paragraph 91 of AASB 13/IFRS13: (a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements. (b) For recurring fair value measurements using significant unobservable inputs (level 3), the effect of the measurement on profit or loss or other comprehensive income for the period.

Our research will focus on the re-evaluate some elements of financial instruments in the company under study. Thence, determine the impact of re-evaluation for these items on income statement, including net income and comprehensive income.

Acceptable valuation techniques:

Paragraph 62/IFRS 13 goes on to state that there are three widely used techniques. (a) The market approach is based on the ability to identify a market for an identical or comparable asset or liability. This approach is theoretically most directly related to the intention of the standard. Depending on the nature of the market, adjustments may need to be made to take existing transactions and best approximate the price that would be relevant to the specific item under consideration. The share market would be an example of a market for identical asset. (b) The income approach is based on converting future cash flows or income and expense into a single present value. In the absence of a market price the expected net income/expense should proxy for a market price. (c) The cost approach is based on an estimate of the cost of replacing the "service capacity" of the asset under consideration. This is what is known as the current replacement cost in accounting theory. The cost is calculated not based on a new asset, rather an asset that would substitute to derive comparable benefit, taking into account the "obsolescence" of the current asset. In practice this would mean that the market approach is most likely to be preferred. However, this also means that where a market is inactive, alternative valuation methods are available to an entity.

IFRS refers that unrealized gains or losses on trading securities should included as a part of other income and expense in the income statement. Otherwise, other comprehensive income, therefore, includes all gains and losses that bypass net income but affect equity such as unrealized gains or losses related to non-trading securities, unrealized gains or losses on certain hedging transactions (derivatives), translation gains and losses on foreign currency, actuarial gains and losses in certain situations, changes in revaluation surplus, and others (Kieso & others, 2011).

Companies may transfer the balance of unrealized holding gains or losses in accumulated other comprehensive income to retained earnings. Transferring the balance to retained earnings has merit, as these gains or losses would have been recorded in net income (when a non-trading investment is sold) in a prior period if these securities were accounted for as trading securities.

Methods and data:

The researcher Will focus on the concept of comprehensive income and its usefulness for users, will also focus on clarifying the relationship between the concept of comprehensive income and the concept of tradition net income, where they will be measuring comprehensive income after calculating net income and by measuring the unrealized gains or losses on the value of trading securities and non-trading securities (held for sale), and measuring the unrealized gains or losses on financial derivatives, and measure their impact on comprehensive income for the company.

Below is a list of income for the company under study for the period ended December 31, 2013, and taken from its financial statements published without taking into account the impact of the fair value measurement on financial instruments. They are as follows:

Table (1): Income Statement for the Period Ended December 31, 2013

Net sates		$3433919
Cost of goods sold		2327521
Gross profit		1106389
Selling expenses	436720	
Administrative expenses	333642	-770362
Other income and expense		+177829
Income from operations		513856
Interest expense		122355
Income before income tax		391501
Income tax		97875
Net income for the year		293626

From the table above, the Company under study has made the amount of 293626 as net income for the year ended December 31, 2013. It should be noted that this amount did not show the impact of fair value measurements.

The next step will include identifying some financial instruments that the researcher will re-evaluate them according to their fair values, and according to IFRS 13 requirements, a prelude to measure their impact to income statement.

Table (2): Some of the financial instruments for the period ended December 31, 2013 at the historical cost

Assets	**The value in 31/12/2013**
Trading equity securities:	
Banks securities	$1700000
Other insurance company's securities	$1600000
Derivatives:	
Interest rate contracts	$216000
Foreign exchange contracts	$170000
Non-trading securities	
Non-trading securities	$3220000

The researcher has to choose certain financial instruments, which could in collaboration with the management of the company under study evaluates these tools according to the fair value measurements techniques in order to determine the impact of evaluation these instruments at fair value at the measurement date (the date of the preparation of financial statements) to the income statement.

The following table shows the data that have been obtained for these instruments which have studied. The researcher depend on the three known valuation techniques to determine the fair value for financial instruments under study. We shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

For trading equity securities, and on the basis of its analysis of the nature, characteristics and risks, the working team has determined that evaluating them by level 1 (quoted prices in active markets) is appropriate. For derivatives, and on the basis of its analysis of the nature, characteristics and risks, the working team has determined that evaluating them by quoted prices in active markets is inappropriate. So they transfer to the level 2 (significant other observable inputs) to evaluate them. For non-trading equity securities, and on the basis of its analysis of the nature, characteristics and risks, the working team has determined that evaluating them by level 1 (quoted prices in active markets) is appropriate

The results indicate that bank securities have achieved ($30000) as unrealized losses by revaluation those by using fair value measurements. While, other insurance company's securities have achieved ($223000) as

unrealized gains by revaluation those by using fair value measurements. For derivatives, ($27000) as unrealized gains by revaluation Interest rate contracts by using fair value measurements, and ($26000) as unrealized gains by revaluation Foreign exchange contracts by using fair value measurements, and for non-trading securities, ($45000) as unrealized gains by revaluation those by using fair value measurements.

Table (3) fair value measurements at the end of the reporting period using

Description	31/12/2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)	Total Gains (losses)
Trading equity securities:					
Banks securities	$1700000	$1670000			($30000)
Other insurance company's securities	$1600000	$1823000			$223000
	$216000				
Derivatives:					
Interest rate contracts	$170000		$243000		$27000
Foreign exchange contracts			$196000		$26000
	$3220000	$367000			
Non-trading securities					
Non-trading securities					$45000

How fair value measurements effect on income statement?

Corporate income generally includes all income and expenses, and gains and losses realized during any period. These items are classified in the income statement so that readers of financial statements better understand the importance of the various components of net income. In recent years, there has been a significant increase in the use of fair value to measure assets and liabilities. Moreover, the gains and losses related to changes in the fair value has imposed great pressure on reported income. Because the fair value is constantly changing, some argue that the recognition of these gains and losses in net income is misleading. (Kieso & others, 2011).

International Accounting Standards Board has agreed that the unrealized gains or losses related to trading securities has can be displayed in other income and expenses within net income. Otherwise, IASB limited number of transactions that should be recorded directly in equity, such as gains and unrealized losses on securities available for sale, not for trading which have been identified. This excludes gains and losses from net income. IASB requires These elements include that exceed the income statement in the measurement of the comprehensive income. Comprehensive income includes all income and gains, expenses and losses reported in net income, and all gains and losses, which exceeded net income, and impact on shareholders' equity. Referred to these items to other comprehensive income. International Accounting Standards Board has also decided that companies must display component of other comprehensive income items in one of two ways: (1) the second statement of income or (2) the consolidated statement of comprehensive income (Kieso & others, 2011).

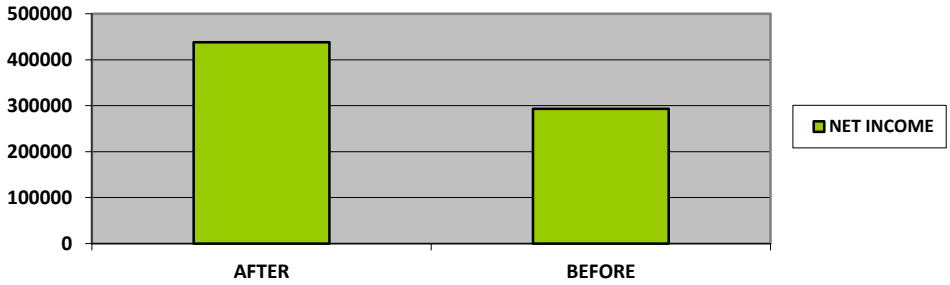
The following table is an income statement for the same company under study, but according to fair value measurements and regarding those financial instruments which have revaluated according to fair value techniques.

Table (4): Income Statement for the Period Ended December 31, 2013 by considering fair value measurements

Net sates		$3433919
Cost of goods sold		2327521
Gross profit		1106389
Selling expenses	436720	
Administrative expenses	333642	-770362
Other income and expense		+177829
Unrealized loss on trading securities		(30000)
Unrealized gains on trading securities		223000
Income from operations		**706856**
Interest expense		122355
Income before income tax		**584501**
Income tax		146125
Net income for the year		**438376**
Other comprehensive income		
Unrealized gains on derivatives **(net of tax)**		**39750**
Unrealized gains on non-trading securities **(net of tax)**		**33750**
Comprehensive income		**511876**

The results indicate that there is a significant difference between net incomes before applying fair value measurements and after applying it. Net income before applying fair value measurements has $293626, whereas, Net income after applying fair value measurements has $438376. And on the other hand, Comprehensive income after applying fair value measurements become $511876 which is very different to Comprehensive income before applying fair value measurements, which is the same net income. The following diagram summarizes net income after and before applying fair value measurements:

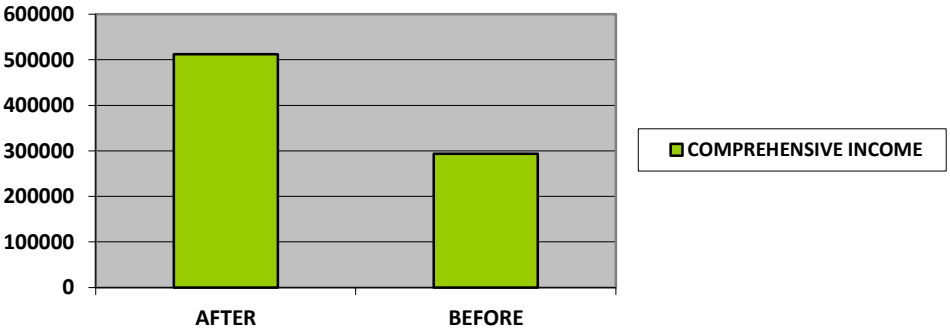
Figure 1- Net Income for the year 2013 after and before applying fair value measurements



This diagram shows clearly the fundamental differences between net income after and before applying fair value measurements to some of the financial instruments for the company under study.

The following diagram summarizes comprehensive income after and before applying fair value measurements:

Figure 2- comprehensive Income for the year 2013 after and before applying fair value measurements



This diagram shows clearly the fundamental differences between comprehensive income after and before applying fair value measurements to some of the financial instruments for the company under study.

Hypotheses Test:

H1: There is a significant difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle.

H2: There is a significant difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle.

Test of the first hypothesis

The first null hypothesis states that "There is no significant difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle."

Table (5): The results for net incomes and incomes from operations after and before applying fair value measurements.

	Net Income and Income from operations	
	After	**Before**
Revenues	$3433919	$3433919
Income from operations	706856	513856
Net income	$438376	$293626
Percentage of net income to revenues	%12.7	%0.08
Percentage of income from operations to revenues	%20.5	%14.9

The table shows that the percentage of net income to revenues is %12.7 after applying fair value measurements, and %0.08 before applying fair value measurements. Also, the percentage of income from operations to revenues is %20.5 after applying fair value measurements, and %14.9 before applying fair value measurements.

These differences are a significant proportion and prove the first hypothesis of this search, which states "There is a significant difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle ".

Test of the second hypothesis

The second null hypothesis states that "There is no significant difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle."

Table (6): The results for net incomes and incomes from operations after and before applying fair value measurements.

	Net Income and Income from operations	
	After	**Before**
Revenues	$3433919	$3433919
Comprehensive income (the same net income before)	$511876	$293626
Percentage of comprehensive income to revenues	%14.9	%0.08

The table shows that the percentage of comprehensive income to revenues is %14.9 after applying fair value measurements, and %0.08 before applying fair value measurements.

This difference is a significant proportion and proves the second hypothesis of this search, which states "There is a significant difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle".

Results:

The following points represent the results:

1. Fair value measurements effect clearly on the income from operations, either increasing or decreasing.
2. Fair value measurements effect clearly on the net income, either increasing or decreasing.
3. Fair value measurements effect clearly on the comprehensive income, either increasing or decreasing.
4. There is a significant difference between net incomes and incomes from operations by using the two principles; historical cost principle and fair value principle.
5. There is a significant difference between comprehensive incomes by using the two principles; historical cost principle and fair value principle.
6. Applying fair values reflect fairly disclosing in financial statements.

Recommendations:

The following points can be considered as real recommendations in this field:

1. The importance of maintaining the continuity of the application of fair value accounting and follow-up contingencies for which the Developments in international standards.
2. The need to establish the concept of application of fair value accounting, characteristics and methods of measurement has Working in the field of accounting for financial instruments.
3. The application of fair value accounting requires the development of interest in the performance of employees professionally through Interest in vocational rehabilitation for workers in the finance departments of listed companies in the financial market Especially preparers of financial reports through holding training courses specializing in standards In particular, the accounting standards related to fair value.
4. Need to focus on the process of financial analysis because of their active role in the statement of financial position of the facilities As well as its role in the rationalization of investment decisions by what was done to the process of analysis of the implications of Task, and not relies on preliminary indications of the financial statements published only.
5. Finally, the study recommends the establishment of the importance of further studies on the impact of future Application of fair value accounting for all companies listed on the financial markets of During the time series for years enjoyed relative stability in market prices.

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