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The Effect of Managers Discretion in Fair Value Measurement on Investment Selling Decisions

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ABSTRACT

Fair value accounting for valuation of assets and liabilities has given managers the discretion.The purpose of this study is to investigate the effect of manager's discretion allowed in fair value measurement on investment selling decisions. In order to test the research hypothesis, a questionnaire based on the scenario was used. This questionnaire is based on Green et al. (2015). The statistical population consists of all active financial analysts in investment companies and stock exchange brokers and the statistical sample of the study was determined using the sample size tables of Cohen et al. (2000) of 268 people. Multivariate analysis of variance (MANOVA) and univariate analysis of variance (ANOVA) were used to analyze the data and test hypothesis. The results of this study showed that conservatism and its interaction with the fair value volatility have a significant effect on the investment selling decisions based on fair value, but the fair value volatility has no significant effect on these decisions. Overall, the results of the research showed that the directors' discretions in fair value accounting affects investment selling decisions.

1- Introduction

Accounting academics and practitioners have been debating the reliability and relevance of fair value accounting. According to Financial Accounting Standards, fair value accounting, often referred to as mark-to-market occurs when a firm revalues assets and liabilities based on an exit

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price. Advocates contend that fair value provides valuable and timely information to financial statement users by increasing transparency that aid in assessing firm value. In contrast, opponents argue that fair value is transitory because once the asset or liability is traded, the related accounting entries are reversed (Green, 2015). Thus, fair value may provide misleading and unreliable information. In particular, Level 3 fair value assets have no observable inputs and are valued by managers' assumptions, thus the fair value is subjective (Zyla, 2013).

Level 3 fair values are unique in that subjective assumptions that are necessary to arrive at the fair value are based on unobservable inputs. According to the IASB codification glossary, unobservable inputs are defined as "market data that are not available and that are developed using the best information available about the assumptions that market participants would use 2 when pricing the asset or liability". Depending on the valuation method selected, discretion can include the expected life of the asset or liability, the cash discount rate, and risk return rates (Zyla, 2013). This discretion can affect financial statements.

Prior reserch has established that factors such as earnings management (Dechow and Shakespear, 2009, Dechow et al, 2010), optimism (Kedia and Philippon, 2009), national culture (Ball et al., 2000), fear of litigation (Lobo and Zhou, 2006), and auditor compliance (Milbradt 2012) influence the recognized fair value. However, limited research has examined how managerial behavioral effects prior to recognizing fair value (Chen et al., 2013, Green, 2015).

Motivated reasoning theory contends that individuals will perceive information in a manner that will benefit their desired outcome (Kunda 1990). Thus, managers are likely to view a fair value that results in gains as a valid representation of the true underlying value. Because of the resulting unrealized gains, managers will be motivated to base Level 3 fair value selling decisions at the fair valuation amount (Green, 2015).

When examining manager's likelihood to sell a Level 3 fair value asset or liability, prospect theory (Kahneman and Tversky, 1979) suggests that only unrealized gain from the increase of the recognized fair value will motivate managers to be risk averse. In order to preserve the unrealized gain, managers will not sell the asset or liability if the market offers a price less than the most recent recognized fair value (Green, 2015).

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2- Hypothesis

Based on theoretical foundations and research background, the research hypothesis can be expressed as follows:

H1: *The conservative level used in the assessment of fair value affects the decision to sell investment at the 3 level of fair value.*

H2: *The level of historical volatility of fair value affects the decision to sell investment at the 3 level of fair value.*

H3: *The interaction of the level of conservatism and the level of historical volatility of fair value, affects the decision to sell investment at the 3 level of fair value.*

3- Methods

This research in terms of purpose is a fundamental research, in terms of method is quasi-empirical and in the point of data collection is survey. In this research, to test the research hypothesis, a questionnaire based on the scenario was used. This questionnaire is based on Green (2015). The statistical population consists of all active financial analysts in investment companies and stock exchange brokers and the statistical sample of the study was determined using the sample size tables of Cohen et al. (2000) of 268 people. Multivariate analysis of variance (MANOVA) and univariate analysis of variance (ANOVA) were used to analyze the data and test hypothesis.

4- Results

The results of this study showed that conservatism and its interaction with the fair value volatility have a significant effect on the investment selling decisions based on fair value. However, the fair value volatility has no significant effect on these decisions. The other results showed that financial analysts' demographic characteristics do not have a significant effect on investment decision-making. Overall, the results of the research showed that the directors' discretions in fair value accounting affects investment selling decisions.

5- Discussion and conclusion

Findings of the research indicate that with the increase in the level of conservatism used in the assessment of fair value, managers' willingness to sell investments increases. This result is consistent with the motivated

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reasoning and the prospect theory. The results of this study are consistent with the results of Green (2015). In addition, the results of the research showed that the historical volatility of fair value does not affect the decision of investment sales. This result is not consistent with agency theory and prospect theory, but is consistent with the results of Green (2015). The sensitivity analysis of this result suggests that, the increase in the fair value volatility, the asking sales price and the probability of sales below the current fair value has not increased and did not reduce the lowest acceptable price.

Keywords: Manager Discretion, Conservatism, Fair Value Volatility, Investment Selling Decisions.

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