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**Information Perspective Depends on Single-person Decision Theory**

The information perspective depends on single-person decision theory.[[1]](#footnote-1) Future firm performance must be predicted by the individual investor in this case. Accountants provide useful information and auditors verify the reliability of such information. The information perspective is thus rooted in historical cost accounting, supplemented by information provided in notes to the financial statements. Historical cost accounting has reliability due to neutrality, validity, and verifiability. The measurement perspective adds more emphasis on fair market value in order to increase relevance of financial information. More relevant financial information has predictive value, feedback value, and timeliness. I believe that the measurement perspective provides a greater service to users of financial information because the information is inherently more reliable and consistent. It is the job of the stock or industry analyst to use high quality accounting information to determine a valuation. I believe that incorporation of more fair value information in financial statements should be done sparingly. Charging management and accountants with valuation responsibilities tied to fair market values could create information that is not reliable to end users.

The information perspective of accounting protects the quality of information that users can utilize. I agree with W.H. Beaver, in that the market can interpret information from any source, as long as it is reliable.[[2]](#footnote-2) It is the job of the analyst to use reliable data to come up with market valuations that are based upon the analysts opinions’ and assumptions, not managements’. An example of reliability of the information perspective is keeping fixed assets at historic costs, unless impaired. The Coca Cola Company, for example, has 9.01 billion dollars of assets, net of depreciation on the balance sheet.[[3]](#footnote-3) It is up to the investor to realize that some of these assets were bought decades ago and do not reflect fair market value. While incorporation of more fair value information into accounting would provide feedback value, I would not trust the judgment of management.

Historical cost basis accounting helps prevent moral hazards of charging management with the job of subjective measurement. Any rule subject to interpretation will be also subject to abuse. Even if a measurement approach could be used for more accurate results, someone would find a way to abuse it. It is unfair to give auditors and accountants the responsibility for assigning values that may or may not be accurate. A few bad apples could turn a theoretically good idea into a monstrosity.

Fair value accounting for financial instruments may or may not decrease the potential for opportunistic earnings management for bonus purposes. Hard to value securities traded in illiquid markets open the doors for earnings abuse. “Fair Value” if assigned by management will nearly always benefit the bottom line. I witness such “Fair Value” judgments when it comes to bank appraisals of foreclosed property as a tax preparer. I find that banks typically value abandoned properties from foreclosed properties considerably higher than market rates. When faced with subjective decision making, management will be hesitant to adjust values if it means a reduction in earnings. Bank of America in the first quarter of 1010 only recently starting significant write-downs of its loan portfolio.[[4]](#footnote-4)

Fair value accounting, while rooted in good intentions can actually open the proverbial Pandora’s Box. Companies such as Enron failed partly because of internally assigned “fair values” it used to book current period earnings.[[5]](#footnote-5) Fair values are subject to interpretation and can be even manipulated by outside forces if the motivation exists. Whether energy trading or mortgage backed security trading, difficult to value accounting items have a history of being manipulated. Opening the door for more subjective accounting is dangerous.

Generally Accepted Accounting Principles already allow certain assets and liabilities to be valued at fair market value once elected. Management can therefore make permanent elections on an item to item basis on items such as debt or marketable securities at fair market value if they wish. Using fair value accounting on items such as mortgages, derivatives, and bonds can help users evaluate items that analysts otherwise could have difficulty with. In the case of Lehman brothers, stricter measurement practices could have prevented the sudden collapse. The implementation of such regulation, however, remains a challenge.

The information perspective and measurement perspective both share a role in an ideal accounting system. Incorporating more fair values in financial statements has an important role, especially in hard to value items such as derivatives. Opening the door too much, however, can lead to earnings manipulation and a decline in the value of the financial information presented. Footnotes still serve as an area where management can express important information outside of the information perspective constraint. In the spectrum between reliability and usefulness, I believe that reliability is generally more important to the financial statements because good quality data can be analyzed and utilized by end users effectively.

1. Toronto: Pearson Education Canada, 2009 [↑](#footnote-ref-1)
2. Beaver, W.H., “The Information Content of Annual Earnings Announcements,” Journal of Accounting Research (Supplement, 1968), pp.67-92. [↑](#footnote-ref-2)
3. The Coca-Cola Company, Unaudited 10Q, Oct, 29 2009.

   http://ir.thecoca-colacompany.com/phoenix.zhtml?c=94566&p=IROL-sec&control\_selectgroup=Quarterly%20Filings [↑](#footnote-ref-3)
4. Corkery, Michael. “BofA’s Principal Writedowns: What took Them So Long”

   The Wall Street Journal. 24 March. Web. 27 March 2010

   http://blogs.wsj.com/deals/2010/03/24/bofas-principal-writedowns-what-took-them-so-long/ [↑](#footnote-ref-4)
5. Thomas, William. “The Rise and Fall of Enron.”

   Journal of Accountancy. April 2002. Web. 27 April 2010.

   http://www.journalofaccountancy.com/Issues/2002/Apr/TheRiseAndFallOfEnron.htm [↑](#footnote-ref-5)