ProBisnis : Jurnal Manajemen, 14 (5) (2023) pp. 48-52

Published by: Lembaga Riset, Publikasi, dan Konsultasi Jonhariono

ProBisnis : Jurnal Manajemen

Journal homepage: www.jonhariono.org/index.php/ProBisnis

Basic Concepts of Fair Value Measurement: Analysis of PSAK 68

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ARTICLE INFO

Article history:

Received Oct 6, 2023
Revised Oct 15, 2023
Accepted Oct 24, 2023

Keywords:

Basic Concept
Fair Value
PSAK 68

ABSTRACT

In recent years, the accounting world in Indonesia has focused on the application of new accounting standards oriented to the International Financial Reporting Standard (IFRS) issued by the International Accounting Standard Board (IASB), which compares the concept of fair value to the old concept of book value and reports submitted more relevant. This article aims to explain the application of the basic concept of fair value measurement based on the convergence of IFRS and PSAK 68 as a substitute for historical costs using the literature study method. The results of this study reveal that in Indonesia the concept of fair value was fully implemented in 2012 and in its application fair value has a relevant nature.

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1. INTRODUCTION

Based on the Statement of Financial Accounting Concept (SFAC) No. 1, it states that the main purpose of making financial reports is to provide financial information for interested parties in the context of making economic decisions. In the perspective of agency theory, financial reports are a means of accounting for management's performance as agents for the resources of shareholders as principals. A company that has gone public has an obligation to publish its financial reports. Agency theory is based on the relationship between shareholders as principals and management as agents, both parties are separate and have the desire to obtain maximum profits (Aziz et al., 2022).

However, over time accountants have discovered many loopholes in their existing financial reporting approaches to commit fraud. Therefore, this is one of the reasons for the emergence of principal based accounting standards, namely IFRS (International Financial Reporting Standard) (Sukendar, 2012). Accounting standards are needed to ensure consistency in financial reporting, inadequate accounting standards will have negative implications in the form of low reality and objectivity of the information presented, inconsistencies in financial reporting will also make auditing activities difficult (Bangsawan & Abbas, 2021).

The demand for transparency has encouraged IAI to harmonize with international accounting standards, namely the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The logical consequence of the convergence of IFRS-based accounting standards is that the method of measuring or assessing elements of financial statements has changed, accounting practices which originally used historical costs must be adjusted based on the concept of fair value because IFRS uses fair value as a basis for measurement or assessment. IFRS applies the concept of fair value to all standards that have been issued, because fair value can increase transparency, accountability and comparability of financial reports (Hardiani & Chariri, 2014).

Before using IFRS, accounting in Indonesia used historical costs to measure transactions. In this concept, items in the financial statements are measured at cost when the transaction occurs. This cost will be the basis for reporting the number of items for the next period as long as the item is still being reported (Bahri, 2020). The advantage of using the historical cost approach is that the amounts of financial statement items can be easily proven because they are based on transactions that occurred, but if the value of an item in the market decreases or increases (which may be due to inflation or deflation, or product shortages, etc.), the item reported will not reflect the value of these changes. Today, the use of historical costs is no longer relevant because over time the reliability and usefulness of financial statements is hampered by serious problems. And many people think and believe that accounting standards using historical costs played an important role in causing the economic downturn, especially savings and loan institutions in the 1980s and 1990s. This was because many financial reports at that time did not immediately reveal losses when they occurred (Schroeder et al., 2020).

IFRS uses "Principles Based", which places more emphasis on the interpretation and application of standards so it must focus on the spirit of implementing these principles. The standard requires an assessment of the substance of transactions and an evaluation of whether the accounting presentation reflects economic reality. Then, it requires professional judgment in the application of accounting standards. IFRS requires more disclosure, both quantitative and qualitative, and uses fair value in the assessment. If there is no active market value, you must carry out your own assessment (requires competency) or use the services of an appraiser. When viewed from the perspective of information availability, one of the advantages of fair value-based financial reports is that they can provide more complete information compared to historical costs (Hardiani & Chariri, 2014). However, there are many conflicts that occur and debates that ultimately arise due to IFRS accounting standards, because in some countries accounting standards are formed politically, and in other countries accounting standards are formed based on private professional mechanisms. In writing this scientific article, the author will present fair value measurement in several aspects, such as how each fair value is implemented in PSAK and IFRS, its comparison with historical costs, and what problems often arise from the implementation of fair value measurement.

Currently, Indonesia has adopted several IFRS standards, one of the standards that has been adopted is IFRS 13 Fair Value Measurement. IFRS 13 has been adopted into the Statement of Financial Accounting Standards (PSAK) 68 Fair Value Measurement which is effective January 1 2015. Fair value measurement according to PSAK 68 is the price that will be received to sell an asset or the price that will be paid to transfer a liability in a transaction regularly between market participants on the measurement date. The FASB in its latest statement 157 states that fair value measurement is the exit value, with a sign of agreement from the IASB with several minor reservations: "fair value is the price that would be received by selling an asset or would be paid to transfer a liability in a transaction between participants market participant on the measurement date”. Fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability; or if there is no main market, in the most advantageous market for the asset or liability. Fair value is the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction in the primary market (or the most profitable market) at the measurement date under current market conditions (i.e. the exit price) regardless of whether that price is can be observed directly or estimated using other assessment techniques.

PSAK 68 establishes a fair value hierarchy that groups inputs for valuation techniques used in fair value measurements into three levels of input, namely: Input Level 1, which is a quoted price (without adjustment) in an active market for an identical asset or liability that the entity can access at measurement date. Quoted prices in active markets provide the most reliable evidence of fair value and are used without adjustment. The emphasis at level 1 is to determine both the primary market for the asset or liability or, if there is no primary market, the most profitable market for the asset or liability and whether the entity can enter into transactions for the asset or liability at prices in that market on the date measurement. An entity does not make adjustments to level 1 inputs except in certain circumstances, namely they are not accessible for each asset or liability individually, quoted prices in active markets do not represent fair value at the measurement date, and assets in active markets and their prices need to be adjusted to factors that are specific to the item or asset.

Then there is Level 2 Input, which is input other than quoted prices included in Level 1 which can be observed for assets or liabilities, either directly or indirectly. If an asset or liability has specific (contractual) terms, Level 2 inputs must be observable for the entire substantial term of the asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than observable quoted prices for assets or liabilities, and inputs that market-corroborated inputs. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Such factors include the condition or location of the asset, the degree to which the input relates to items comparable to the asset or liability, and the volume or level of activity in the market in which the input can be observed.

Lastly, Input Level, is an unobservable input for assets or liabilities. Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available. Assumptions regarding risk include the risks inherent in certain valuation techniques used to measure fair value (such as pricing models) and the risks inherent in the inputs to the valuation techniques. Entities can develop unobservable inputs using the best information available.

2. RESEARCH METHOD

In this research, library research methods were used as a reference for the research. Research using this method takes the form of conceptual analysis, which is the creation of the existence and frequency of a concept, usually presented in the form of phrases (in the form of literature) contained in a text. The focus of this analysis is to observe the issue of fair value, which is a new and important event in the world of accounting today, as well as to support research objectives. As a benchmark, the author uses several literature references, such as Wiley's 2010 IFRS book, which explains the basic concepts of international standard accounting reporting, maps the challenges faced, and describes efforts to overcome computational problems. Briefly explains the definition, benefits, measurement, recognition, reporting and disclosure of the application of the fair value concept, based on reference books, modern accounting concepts. This research explains the reasons for the emergence of fair value measurements from various research results using library research methods, and concludes the main causes of the application of fair value.

3. RESULTS AND DISCUSSIONS

Implementation of Fair Value in Indonesia

The implementation of fair value in Indonesia in the world of business and accounting in particular has given rise to a lot of debate among local business people, some of whom are on the supporting side (pro) and others are on the opposing side (con). Basically, whether you like the concept of fair value or not, you have to accept it well. In Indonesia itself, they preferred to postpone the implementation of fair value because the market situation was known to be unstable and the conditions were not yet ready, so they only implemented fair value fully in 2012. Of course, this is different from the United States, which implemented fair value gradually and has regulated in a complex, detailed and detailed manner by GAAP.

However, in Indonesia itself DSAK has prepared all its standards referring to IFRS/IAS, including the concept of fair value and has also published a technical bulletin as a guide in calculating fair value in these standards. Because the Pronouncement of the International Accounting Standard Board has almost entirely implemented the basic value of fair value, Indonesia will adopt it gradually. Many business actors are not ready to implement fair value because of the concept of openness and transparency towards investors who want to know the contents of the company, one of which is the banking sector. PSAK 50 and 55 concerning Financial Instruments, which were originally intended to be implemented several years ago, have been postponed several times. In the end, the Indonesian Banking Accounting Guidelines (PAPI) were implemented by Bank Indonesia (BI), because according to him, when compared with other sectors, the application of fair value in the banking sector is classified as the most complicated and complex because not all financial instruments or bank assets are traded on the capital market. .

Various steps in implementing fair value must be prepared by all related parties, this is because all PSAK issuances by DSAK will be required to serve as guidelines for preparing fair value-based financial reports. If after 2012 there are companies that do not use fair value in their financial reports, the auditor will give an unclean opinion which will reduce public trust. Even though IFRS will only be implemented in full in 2012, both regulators, business actors and other related parties must make serious efforts to ensure that fair value is implemented in line with expectations. Because business actors or investors will benefit from fair value which actually reflects market value.

There are several advantages of fair value compared to book value, namely: (1) the basis for decision making in financial reports is relevant; (2) comparability of financial reports increases; (3) information about the desires of users of financial reports becomes closer. The profit/loss of a company can be predicted well in advance by applying fair value determination and a market price approach. However, for fair value itself there will be several complicated obstacles. For example, determining whether a market is active or not is a problem that is not easy and quite crucial. Because in certain instruments the market is active, but becomes inactive in other instruments. Another thing is that to justify a market being active, sometimes it is not enough just to have willing sellers and willing buyers, because forced transactions, forced liquidation or distressed sales may not reflect the true fair value of the prices formed.

Advantages and Disadvantages of the Fair Value Concept

The advantage of having fair value is that it has the characteristic of being relevant, because according to the accounting standards themselves, much of the relevance of the book has been lost due to failure to measure economic reality. Apart from that, fair value financial reports are more transparent because they strive to increase the provision of more transparent information for all parties. Fair value can also increase the comparability or comparability of the application of the fair value concept in all world companies, which will result in more fundamental business decisions.

The lack of fair value is due to efforts to provide transparent information in assessing assets from the price level obtained if immediate liquidation is carried out which will cause a sensitive response to the market. Fair value accounting also works through mark to market accounting where assets are entered at market prices which are traded openly and will later result in recorded profit and loss statements and financial reports which continually change when the asset value increases or decreases. And it will be difficult to ascertain whether profit and loss is caused by management in making business decisions or caused by market changes.

Fair Value Involvement in the Business World

There are three conventional methods for assessing assets and liabilities in accordance with accounting standards, namely (1) taking a market approach with market prices because the approach taken is directly from the comparison, namely assets or liabilities that have value in the market; (2) still using a market approach, but the difference is using income value considerations if the comparison is limited; (3) by taking a cost approach or what is usually called depreciated replacement cost or depreciated replacement cost.

In IFRS/IAS, the meaning of fair value is stated to be materially consistent. Of all the PSAKs in force in Indonesia to date, only 11 PSAKs are declared to use fair value, and those that are declared to use identical fair values are only PSAK 50, 55, and 60, while the other nine PSAKs do not state the same definition of fair value as a result of not consistency of a translator. Apart from inconsistent definitions, this also applies to the various methods of determining fair value in PSAK and their inconsistency with each other. The result of this inconsistency could result in the IASB's main goal not being achieved in achieving a single standard of high quality, easy to understand and globally accepted and implemented from IFRS. There are those who use three stages in the fair value provisions in some PSAKs, there are also those who use two stages, and others who do not use them according to the method for determining fair value.

4. CONCLUSION

The application of fair value in Indonesia in the world of business and accounting in particular has given rise to a lot of debate among local business people, some of whom are on the supporting side (pro) and others are on the opposing side (con). Therefore, Indonesia only fully implemented fair value in 2012. Fair value means it has the characteristic of being relevant, because according to the accounting standards themselves, much of the relevance of the book value has been lost due to the failure to measure economic reality. Apart from that, fair value financial reports are more transparent because they strive to increase the provision of more transparent information for all parties. Fair value can also increase the comparability or comparability of the application of the fair value concept in all world companies, which will result in more fundamental business decisions. The lack of fair value is due to efforts to provide transparent information in assessing assets from the price level obtained if immediate liquidation is carried out which will cause a sensitive response to the market.

PSAK 68 establishes a fair value hierarchy that groups inputs for valuation techniques used in fair value measurements into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has access to at the measurement date. Level 2 inputs are inputs other than quoted prices included in Level 1 that can be observed for assets or liabilities, either directly or indirectly. Furthermore, level 3 inputs are unobservable inputs for assets or liabilities. Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available. To be able to apply the fair value of all company assets comprehensively, companies must begin to take into account the fair value hierarchy prioritizing input over valuation techniques, not the valuation technique used to measure fair value.

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