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The Application of Fair Value in Commercial Banking and its Relationship to Transparency Financial Statements - Evidence from Iraq

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Abstract. The research aims to demonstrate the impact of applying this measurement in improving the transparency of financial reporting and its application in Iraqi companies. A high level of transparency in the financial statements has been shown. It has been concluded that the level of transparency of the financial statements when choosing the fair value measurement is higher than the level of transparency when choosing the historical cost measurement, which helps in comparing the financial statements of the different economic units, and that the basis of comparison between it and the measurement based on Historical cost is to achieve the required amount of appropriateness characteristic and honest representation.

Keywords. Fair Value, Historical Cost, International Financial Reporting Transparency. Iraq

1. Introduction

The research focused on one of the problems related to accounting measurement and choosing the appropriate accounting measurement when applying international accounting reporting standards. According to Al-Masoudi and Daoud (2020), the information provided by measuring the fair value at the time of providing the information is seen as more appropriate, which means that it provides more transparent financial information, and because Not being able to dispense with the features of relevance and honest representation, a standard on fair value measurement by International Accounting and Financial Reporting Standards (IFRS 13) has been prepared.

The application of fair value accounting achieves the property of appropriateness and honest representation; in addition, it reflects the current and accurate situation of the economic unit, and it works to achieve the objectives of the financial statements by providing accounting information that benefits the beneficiaries as appropriate and credible and achieves a level of transparency of the financial statements.

The Accounting and Regulatory Standards Board in Iraq decided in 2016 to oblige Iraqi banks listed on the Iraqi Stock Exchange to apply the international financial reporting standards for financial evidence issued in 2017. However, the banks did not commit to applying them
except in 2019 and faced challenges in the application, especially in the International Accounting Standard 13. These reasons are the lack of ability to determine the prices of assets in the market. There are many reasons that we can mention in this research paper. Therefore, the researchers decided to study the most useful important bank in Iraq, TBI, to know the development of the application of international financial reporting standards, focusing on International Standard 13 on fair value and measuring the level of transparency. For the bank for the years 2019-2020.

2. Background

According to a study, Piras et al. (2012) addressed the possibility of evaluating any relationship between the fair value hierarchy and variables related to market value and net income, assuming that the data used in the analysis are formally compliant with IAS/IFRS and US GAAP. Moreover, the second level of analysis attempts to assess whether there is any relationship between the changes in the asset value FV1 and the net FV1 value. The study concluded in the first part of the analysis that the market value and net income are related to the value of assets evaluated at a different fair value level. The study also concluded concerning transparency and the unwillingness to include negative information in financial reports. At the same time, Yalamova (2013) sees whether the nature of financial institutions is a factor that affects the perception of investors about the role of management in estimating fair values and noted that the fair value of depository institutions is higher than the fair value of credit institutions, this discrepancy is a result of exposure to risks between depository and non-custodial institutions.

The study of Saleh et al. (2020) found a significant effect of the orientation of the research sample companies to apply fair value according to the Egyptian Standard 45, which is compatible with International Standard 13 to improve the appropriateness of accounting information, with no significant differences between the categories of the study sample regarding the appropriateness of information based on fair value. The study also indicated a significant effect on fair value to enhance the honest representation of accounting information. It is clear that the application of fair value contributes to avoiding the problems of continuous price hikes in assets and that the expansion of disclosure of information based on fair value increases confidence in the published accounting information, as the results of the study showed that the application of fair value accounting by Saudi joint stock companies increases the degree of reliability of the information contained in their lists. Sufficient information about the current prices of fixed and current assets, but the practical reality in Algeria shows that there is conflicting information published about the in addition to the lack of credibility and transparency of the information, let alone the lack of it sometimes. Concerning the study of Al-Douri & Al-Naimi (2022), they noticed an impact of the use of fair value in the activities of the Commercial Bank of Baghdad after its application. The researchers recommended making the necessary efforts to apply fair value on a larger scale than financial assets to include all of its assets and liabilities for the requirements of International Financial Reporting Standards.

Moreover, the current research agrees with most previous studies regarding applying fair value and its effects on financial information. However, we did not find in the studies that reviewed a link between fair value and transparency of financial reporting, especially in the banking sector in Iraq. Hence, we think it was necessary to address the issue to reach conclusions that benefit the relevant parties regarding their investment decisions in this sector.
2. Literature Review

2.1 Historical cost measurement

According to Bashir (2018), historical cost is one of the most critical pillars on which accounting applications have been based in practice for many years. However, it has been subjected and is still subjected to many criticisms, as its application distorts the results of the work of economic units, which are not consistent with reality. Assets and liabilities appear at the value in which they occurred upon acquisition or acquisition. However, Heaton et al. (2008) indicate that basic economic principles require financial institutions to use market-rate accounting, or fair value, to prepare financial reports. However, the recent turmoil in the financial markets has raised questions about whether fair value accounting exacerbates problems in these institutions or not and raised a question about the possibility of abandoning fair value and returning to historical cost? Melville (2017) and Sarah (2016) show that historical cost measurement does not reveal cash-related gains and losses in the period of inflation, and an entity may lose its purchasing power by holding cash assets. However, purchasing power is gained by retaining its cash obligations and the measurement. The historical cost accountant is not suitable as a suitable basis for measurement because it can no longer provide the appropriate information to make the decision needed by the related parties that use it, which means abandoning objectivity.

2.2 The shift from the historical cost principle to the fair value principle

The accounting measurement works to determine the values of the elements of the company’s financial statements. According to accounting standards, the accounting measurement determines the monetary values of the elements that will be recognized in the financial statements Hanan (2005). Some accounting for the historical cost of the accounting work is associated with economic stability while accounting for fair value is associated with additional disclosure in the case of inflation. At the beginning of the last century, the search for an alternative to cover the negatives resulting from the application of the principle of historical cost, and accordingly, the intellectual framework allowed the application of another principle, which is the fair value and its use as a basis in the accounting measurement of the elements of the financial statements, which led this trend to bring about a revolution in accounting thought, and based on that The IFRS Board and IASB began issuing and amending many accounting standards, which focused in their content on measurement by For fair value Abbas (2013), IAS 13 defines value as the price that would be received in exchange for selling an asset or that could be paid to transfer or transfer a liability in an orderly transaction between market participants at the measurement date. The previous definition focused on four elements: IFRS 13 (2011)

1. The asset or liability subject of the exchange: The measurement with this principle is related to the specific asset or liability, so the company must take into account the characteristics of that asset or liability.

2. Transaction or exchange process Conditions of the exchange transaction that will occur: The exchange process takes place in an orderly transaction between market participants for sale or transfer on the measurement date.

3. Market participants Both sides of the exchange transaction: the participants are the buyers and sellers in the active market

4. Price and the nature of the exchange transaction: It is called the exit price, regardless of whether the price can be obtained directly or estimated using another valuation method.
According to Jaijairam (2013), the fair value is the price between the two parties to the transaction and the desire to exchange the asset.

2.2.1 Fair value according to IFRS 13

It is a standard issued in 2011 related to the evaluation of fair value and effective in 2013. This Standard came after the severe criticism that fair value was subjected to following the global financial crisis in 2008 and included an attempt to define the concept of fair value and its control accurately. The Standard guided how Valuation at a fair value A new definition of fair value has been issued as the price obtained by selling an asset or paid in exchange for transferring liability or transferring ownership in an ordinary transaction between market participants on the valuation date Watchman (2012).

The fair value can be evaluated according to the fair value hierarchy, which determines the priority of the inputs used to measure the fair value into three levels:

Level 1: The inputs to the valuation methodology are prices quoted in active markets for similar assets or liabilities that the company can recognize at the measurement date Needles et al, (2014)

Level 2: Observable inputs other than prices listed in Level 1 for assets or liabilities, either directly or indirectly Yarnold & Ravlic (2014). Level III: It allows the measurement of fair value when there is no active and reliable market, and these inputs are unobservable inputs for assets or liabilities, and there is inaccuracy associated with estimating fair value assumptions and the result in order to use the best estimates, IFRS (13 ) Valuation methods and assumptions used in the

Level 3: estimates are more transparent to reduce risks for investors and other users of financial statements in their decisions Al-Qar’awi (2019)


The fair value provides valuable and appropriate information for the parties that rely on the financial statements in making their economic decisions, and the fair value is a remedy for any shortcoming resulting from the application of the principle of historical cost, in addition to adding transparency to the financial statements issued by the company, and that the change in the fair value reflects changes in the current markets That is, it can reflect changes in the current market condition, and the disclosure process according to the fair value contributes to making the financial market more efficient, and as a result the market response to the information of the fair value and encourage investors to invest more, in particular, the disclosure process will add to them a sense of security, as companies are treated before the emergence of The fair value principle The losses resulting from some hedging tools are reduced to the income statement without the stakeholders’ knowledge of that, but according to Standard (39) the company should show and treat them according to the fair value principle, and as a result it is unable to hide the results of its use of these tools, which leads to the disclosure of the financial statements Very high transparency.

2.3 Transparency of financial statements

In recent decades, interest in transparency has increased in various fields, especially accounting, economics and society. However, it has gained a clear focus in the accounting field, as the lack of transparency in the accounting field causes many financial crises and economic problems, most notably the recent global financial crises. Hanan (2005) This concept has been addressed by researchers from several angles, so it has become necessary to identify the concept and nature of transparency in economic units. It is the presentation of the company's internal
financial statements with complete clarity and the disclosure of information affecting stock prices promptly, provided that a particular party does not achieve extraordinary gains at the expense of the other parties that have a relationship with the company.

According to Mahdi (2011) and Hammad (2010), transparency helps with financial reporting and understanding of the company's situation, in addition to strengthening its ability to evaluate its performance and monitor its management, which is expected to have a positive impact on the company's stakeholders' ability to make rational and appropriate decisions towards the company. In addition to preserving the value of the company by protecting intangible assets such as the brand and goodwill by maintaining the confidence of stakeholders in the company, they gain confidence in the company through transparent disclosure of quality information that shows the consistency of the company's actions with its commitments and obligations. Abdel-Malik & Ahmed (2006), Shehata (2005), Cheng & Lo (2006) Hammad (2011) agree that transparency increases the information contained in the clarifications, which will improve disclosure in the company, as it eliminates misleading and irrational information in order to achieve gains for one party without the other parties. As it prevents the management from trading inside information in the company, sometimes managers give incorrect information about the company's shares, leading to a drop in share prices. As a result, shares will be purchased for them at a reasonable price. Also, raising the level of transparency in financial reports will improve governance in the long run, so transparency is one of the basic principles of governance.

2.3.1 Fair value and transparency standard

The use of the fair value principle may have important implications for the accounting policy because it can affect the selection of the best model for managing the company's current situation. Choosing the appropriate accounting policy for the measurement principle enables a better response to the quality of information by focusing on the reforms undertaken by the company's general management, particularly those associated with transparency Navarro & Rodríguez (2007)

Expanding the use of fair value may lead to favourable adjustments in valuation methods, and this will enhance price transparency and support the development and opening of new markets for instruments that are not currently traded, as well as some active markets that may not exist today for many loan products and other products. However, close to reality and continuous adjustments in evaluation methods can promote the development of new markets for these tools Burkhardt & Strausz, (2006).

In order to obtain financial information that facilitates the comparative characteristic of the qualitative characteristics of the information, the principle used must be appropriate and essential in preparing the financial statements, so the use of the fair value principle according to the estimates prepared on the financial market conditions for each year, will provide more homogeneous values; as a result, it is more beneficial to enhance financial transparency. Barth (2006) and, Muller& Riedl (2002) see that fair value estimates of assets are more reliable when external valuation experts are used compared to internal valuations conducted by the company's management.

3.1 Research Importance

The importance of the research lies in the following:

1) Fair value measurement is a current topic, which is one of the concepts that express the value of the financial statement elements with credibility and fairness, as this concept needs
more clarification, incredibly when clarifying how it is applied in different political, economic and social environments such as the Iraqi environment.

2) A statement of the fair value measurement mechanism and the possibility of its application in the Iraqi environment by the methods and methods proposed by the international accounting and financial reporting standards.

3.2 Problem of the Research
We can summarize the problem with the following main questions:

1) Does fair value measurement provide more reliable and appropriate financial statements for economic events?

2) Does the application of fair value achieve a better level of transparency for the Trade Bank of Iraq?

3.4 Research Aims
The research mainly aims to clarify the impact of fair value measurement in improving the transparency of financial reporting and the applicability of this measurement in Iraqi companies, and it has two branches:

1) Knowing the concept of fair value, how it is measured, and the problems when applying it.

2) Identifying the relationship between accounting measurement methods and the transparency of financial statements and their impact on the availability of qualitative characteristics of accounting information.

3.5 Hypotheses
The research is based on the following hypotheses:

First: The fair value measurement in the financial statements would improve the transparency of financial reporting.

Second: There is no role for a fair value in improving the financial reporting transparency requirements of the Trade Bank of Iraq.

3.6 Research variables and measure
The researchers adopted the analytical method and the case study in the practical and theoretical aspects, as follows:

a. Theoretical section: The researchers followed the analytical approach through sourcing, analyzing and identifying the research variables.

B. The practical section: the researchers followed the case study approach to prove the hypothesis and verify the results, as the following was adopted:

1) Fair value measurement: The International Accounting and Financial Reporting Standard (IFRS13) has applied the fair value measurement methods.

2) Measuring the transparency of financial statements: To measure transparency, a scale (S&P) was applied to determine the transparency of the statements when applying the measurement based on historical cost and to compare it with the level of transparency when applying the measurement at fair value.
4. Findings and Discussion

4. Achieving transparency requirements according to fair value measurement

The banking sector is one of the critical sectors supporting the financial markets through its market-contributing facilities. The role of commercial banks will be discussed because they are one of the most important economic sectors because of their significant role in financing other sectors and supporting them with large capital, in addition to their influential role in developing the market. Securities through investment and investment of funds and the level of transparency of the two research samples (Trade Bank of Iraq and Trade Bank of Iraq) for each bank will be measured according to the (S&P) scale before and after the application of international accounting and financial reporting standards as follows:

4.1 Analysis of the results of the application of fair value to improve transparency of the Trade Bank of Iraq

To prove the research hypothesis, the level of transparency of the financial statements' elements will be measured at historical cost and compared to the level of transparency when measuring at fair value to identify which type of measurement method supports a higher level of transparency. This measurement will take place for the years (2019) and (2020) because the two research samples (The Commercial Bank of Iraq and the Trade Bank of Iraq) have relied on the application of (IFRS) as of (2020). The fair value standard (IFRS 13) is one of the international accounting and financial reporting standards. For the year (2019) they have adopted the measurement in historical cost, which is the year prior to the application of IFRS standards. The measurement of the level of transparency of financial statements according to the Standard & Poor's Transparency Scale will be as follows:

The (S&P) scale contains (79) requirements, and after collecting data on the research sample for the year (2019) (and 2020), the level of transparency will be calculated as follows.

1. Measuring the level of transparency of the Commercial Bank of Iraq: The level of transparency of the bank will be measured in the tables as follows:
   a. When sorting the disclosed and undisclosed clarifications from the data and information of the first sample of the Commercial Bank of Iraq for the year (2019) and counting them through the transparency items in the (S&P) scale, the level of transparency will be as in the following tables:
Table 1: The Transparency Percentage of the Commercial Bank of Iraq and the Percentage of Each S&P Scale for the Year (2019)

<table>
<thead>
<tr>
<th>Items</th>
<th>Indications disclosed</th>
<th>Indications not disclosed</th>
<th>Transparency percentage in item (2÷1)</th>
<th>Transparency ratio = the disclosed indicators to the total indicators (2÷79)</th>
<th>Standard ratios (1÷79)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicators of the item structure of ownership and investor rights</td>
<td>18</td>
<td>11</td>
<td>7</td>
<td>%61</td>
<td>%14</td>
</tr>
<tr>
<td>Hands of financial and non-financial information.</td>
<td>39</td>
<td>21</td>
<td>18</td>
<td>%53</td>
<td>%26</td>
</tr>
<tr>
<td>Indicators item information about the board of directors.</td>
<td>22</td>
<td>16</td>
<td>6</td>
<td>%73</td>
<td>%20</td>
</tr>
<tr>
<td>Total</td>
<td>79</td>
<td>48</td>
<td>31</td>
<td>%60</td>
<td>%60</td>
</tr>
</tbody>
</table>

It is evident from the previous table (1) that the transparency ratio for the year (2019) of the Trade Bank of Iraq is (38%), which results from the sum of the ratios of the disclosed indicators from the three items. However, the information in this item was not disclosed within the Transparency (S&P) measure. As for the item of financial and non-financial information, the transparency rate reached (15%), which is a weak percentage indicating that reporting on financial and non-financial information was not within the required level to be Transparency; as for the percentage of Transparency for the information item on the board of directors, it amounted to (14%), which is considered a somewhat acceptable percentage. By collecting these percentages, the transparency percentage of the Trade Bank of Iraq is a percentage that does not rise to say the bank that it is transparent in the information provided by the beneficiaries.
From the previous table (2), it is clear that the transparency of the Trade Bank of Iraq for the year (2020) amounted to (60%). It can be said that it is a medium percentage, which came by collecting the percentages of the disclosed indicators from the three items, where the percentage of transparency for the item of ownership structure and investor rights was (14%). It is an acceptable percentage indicating that the information about this item is disclosed within the transparency scale (S&P) but not at the required level. As for the financial and non-financial information item, the transparency rate reached (26%), which is also an acceptable percentage indicating that the reporting of financial information and the non-financial level is within the level to be transparent. The transparency ratio for the information item on the board of directors is (20%), which is considered a good percentage. By collecting these percentages, we have a transparency percentage for the Trade Bank of Iraq, which indicates that it enjoys good transparency in disclosing the information it provides to investors and beneficiaries.

To find out the growth rates in transparency for each of the three items in the (S&P) scale and for the total indicators for the year (2019) that did not apply the measurement at the fair value per international accounting and financial reporting standards and for the year (2020) when applying the measurement at fair value by international accounting and reporting standards, as well as in Table (3) below:

<table>
<thead>
<tr>
<th>Items</th>
<th>Indications disclosed</th>
<th>Indications not disclosed</th>
<th>Transparency percentage in item (2÷1)</th>
<th>Transparency ratio = the disclosed indicators to the total indicators (2÷79)</th>
<th>Standard ratios (1÷79)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicators of the item structure of ownership and investor rights</td>
<td>18</td>
<td>11</td>
<td>7</td>
<td>61%</td>
<td>14%</td>
</tr>
<tr>
<td>Indicators of financial and non-financial information.</td>
<td>39</td>
<td>21</td>
<td>18</td>
<td>53%</td>
<td>26%</td>
</tr>
<tr>
<td>Indicators item information about the board of directors.</td>
<td>22</td>
<td>16</td>
<td>6</td>
<td>73%</td>
<td>20%</td>
</tr>
<tr>
<td>Total</td>
<td>79</td>
<td>48</td>
<td>31</td>
<td>60%</td>
<td>60%</td>
</tr>
</tbody>
</table>
Table 3: Comparison of the transparency percentage for the year (2019), (2020) and the percentage change in the level of transparency of the TIB Bank

<table>
<thead>
<tr>
<th>Items</th>
<th>Transparency Ratio for 2019</th>
<th>Transparency Ratio for 2020</th>
<th>difference in ratio (2-1)</th>
<th>percentage change (3-1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>%9</td>
<td>%14</td>
<td>%5</td>
<td>%55</td>
<td></td>
</tr>
<tr>
<td>%15</td>
<td>%26</td>
<td>%11</td>
<td>%73</td>
<td></td>
</tr>
<tr>
<td>%14</td>
<td>%20</td>
<td>%6</td>
<td>%43</td>
<td></td>
</tr>
<tr>
<td>%38</td>
<td>%60</td>
<td>%22</td>
<td>%59</td>
<td></td>
</tr>
</tbody>
</table>

It is clear from Table (3) that the percentage of transparency for each of the three items of the transparency scale ((S&P) increased in (2020) by (22%) over the previous year (2019). This is because of the international accounting and financial reporting standards and the measurement standard at fair value in 2020.

5. Conclusion

Through the theoretical and practical sections that were discussed, the researchers concluded that there are many pressures on the accounting profession in applying some of the principles on which it is based, including the direction of historical cost, which faced severe criticism due to the high prices witnessed by the world, which prompted contemporary accounting thought to make a new approach to measurement. Accounting is the measurement at fair value, which contributes to comparing the financial statements of the various economic units and the basis of comparison between them and the height at historical cost, which achieves the characteristics of appropriateness and honest representation. In the variable and volatile measurement, the fair value measurement provides a lot of transparency compared to the historical cost measurement, as it is not possible to rely on a specific entrance at all times to measure the fair value, but rather the use of the appropriate access that provides the data needed to be used in the measurement, and thus using more than one entrance depending on the circumstances. And then evaluate the results of its stature.

The level of transparency increases when applying international accounting and financial reporting standards and measurement at fair value, as the level of transparency was measured for the two research samples for the year (2020), as it formed a higher transparency rate than the transparency rate when measured by historical cost for the year (2019) according to (S&P) indicators, and this It investigates the hypothesis of the research that fair value
measurement has a role in improving financial reporting transparency and rejects the assumption that there is no role for appropriate value measurement in financial reporting transparency.

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