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# Critical Perspectives on Accounting

journal homepage: [www.elsevier.com/locate/cpa](http://www.elsevier.com/locate/cpa)

## Fair value accounting: Simulacra and simulation

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### ARTICLE INFO

#### Article history:

Received 25 January 2011

Received in revised form 5 May 2011

Accepted 11 May 2011

#### Keywords:

Critical  
Public interest  
Derivatives  
Markets  
Simulacra

#### Mots clés :

Critique  
Intérêt public

#### Keywords:

关键词  
批判性  
公共利益

#### Palabras clave:

Crítica  
Interés Público

### ABSTRACT

The paper examines the application of simulacra and simulation in fair value accounting for financial instruments in the U.S. As copies of copies, simulacra problematize the notion of an original and with it an imaginary of a single authentic reality. We examine simulacra as they have been applied in two interconnected fair value accounting arenas. Firstly, simulacra employed as a measurement basis for certain financial instruments. In this regard, we challenge the FASB's insistence that fair value accounting is an ordinary market based measurement system. Secondly, we examine the process of simulation as employed by the FASB in copying and amending FAS 157 in its subsequent modifications to the guidance provided to the preparers of financial statements. Our purpose here is to both reinforce the absence of a market reality and also to illustrate how the FASB's subsequent modifications to FAS 157 were shaped by political forces. We conclude with some suggestions as to how simulacra and a politicization process might be productively embraced in future fair value accounting endeavors.

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The literature on fair value and fair value accounting (FVA) has a considerable history, spanning a variety of topics (Lee, 2008). It encompasses discussions of the appropriateness of using fair values in accounting statements: 'to fair value or not'. Zeff (2007), for example, traces the SEC's reluctance throughout most of the 20th century to consider valuation methods other than historical cost accounting in U.S. financial statements. In what might be considered the "golden age of normative accounting research" (Lee, 2006, 442; Robson, 1999), scholars such as Baxter (2003), Chambers (1966), Edwards and Bell (1961), and Sterling (1970) extensively debated the merits of different approaches to fair value, their conceptual underpinnings, and their technical ramifications for accounting practice. More recently, with the increased interest shown in FVA both by the FASB and the IASB, many of these earlier debates have resurfaced and have been re-examined from a variety of perspectives (Barlev and Haddad, 2003; Ishikawa, 2005; Walton, 2007).<sup>1</sup> The important point here being that as one academic accountant remarked at a 2008 SEC roundtable discussion of FVA: "[t]his is a topic that has been debated in

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<sup>1</sup> We only address the FASB's deliberations of FVA in this paper.

the accounting profession and the academic literature for five decades and you have 90 days to sort that out” (Ball, 2008: 12). And we would add, the debate is set to continue.

Other discussions have also appeared seeking to locate FVA within a framework sensitive to contemporary priorities: in particular, contemporary financial markets and financial instruments. In this regard, Benston (2008: 102) worries about the ‘manipulability’ of FVA, Ronen (2008: 186) about ‘hazardous’ measures, Bromwich (2007: 4) about ‘a panoply of additional assumptions’ and Whittington (2010: 104) about ‘an idealized view of markets’. Referred to here is the recognition that contemporary financial markets and many instruments pose distinct problems for FVA. In this regard, of particular interest is FVA as it relates to financial derivatives in the current financial crisis. Attention has been drawn to the *imaginary* properties of FVA in this context. Bromwich (2007) and Benston (2008) refer to ‘imaginary prices’, and Power (2009) to ‘imaginary markets’. The imagination and re-imagination of fair values is a central theme in our paper. We believe that the paper adds to these discussions, although from a different perspective and reaching different conclusions. Stated succinctly, imaginary prices and markets need not necessarily be viewed in disapproving terms: what is imagined, by whom and for what purposes is important in this regard.

Our interest in an imaginary or, more specifically, how reality might be imagined and re-imagined, will become more apparent during the course of the paper and in our subsequent discussion of what we refer to as ‘realer than the real’. FAS 157, Fair Value Measurements, and its subsequent amplifications and amendments while not explicitly articulated in terms of an imaginary make oblique reference to the invention of measurements.<sup>2</sup> FAS 157 proposes the use of what it terms Level 3 inputs, or unobservable inputs, for the valuation of certain assets and liabilities, with modifications to the standard specifically addressing issues regarding the valuation of complex financial instruments during the financial crisis. The sheer volume of these instruments should be noted. It has been estimated by the Bank for International Settlements (2009) that as of December 2008, the market value of ‘over the counter’ (OTC) derivatives including credit default swaps amounted to approximately \$33,889 billion. We consider why, how and with what ramifications accounting imaginaries have intersected with these instruments. We also make some proposals as to possible alternative arrangements for future intersections.

In the next section, we outline some conceptual tools which help us unpack and bring into clearer focus the idea of imaginaries and their relationships with accounting numbers. We then provide an overview of FAS 157 focusing specifically upon recommended measurement criteria. The subsequent three sections constitute the empirical terrain of the paper as we consider the content and trajectory of modifications to the standard, or what we consider to be the creation of simulacra within accounting imaginaries. We conclude the paper with our discussion of ‘realer than the real’ and with its some implications for FVA.

## 1. Simulacra and simulation: Our conceptual tools

“present-day simulators attempt to make the real, all of the real, coincide with their models of simulation” (Baudrillard, 1994: 2)

To get a conceptual handle upon the idea of imaginaries led us into the world of Baudrillard and his extensive discussion of the notions of simulacra and simulation. Baudrillard’s exploration of the proliferation of simulacra, or copies of copies produced by an iterative process of simulation, is a, if not the, defining motif for those who discern the advancement of postmodernity. Baudrillard (1983: 5) states it baldly: “simulation threatens the difference between ‘true’ and ‘false’, between ‘real’ and ‘imaginary’.” Baudrillard applies the concept of simulacra to such diverse phenomena as the cinema, advertising, shopping and the media – all ubiquitous influences on everyday life. In each case, Baudrillard observes the construction of new realities or hyperrealities both detached from an original reality and increasingly redefining what is considered to be reality.<sup>3</sup> We are also interested in simulacra as ways of thinking about imaginaries, although in a modified format to Baudrillard’s conceptualization.

It is useful at this point to provide an overview of Baudrillard’s thesis drawing connections and overlaps between his simulacra and ours, before proceeding to consider some points of departure. Very briefly, Baudrillard seeks to problematize reality. For Baudrillard, simulacra should not be considered as imitations of the real, but as ways which while offering images of the real, allow reality to evaporate into hyperreality as copies proliferate. Baudrillard considers this process to have increasingly permeated our world. Importantly, however, in this process he sees a further development: how simulacra now do not model the real but *precede* the real, as it is through simulacra that we discover a real, with reality being forced to coincide with simulacra. Since simulacra and now reality are produced by the calculations and assumptions of the simulator, reformulation and recalibration produce further simulacra and realities. We concur with this analysis. We will subsequently illustrate that the FASB is also acutely aware of this phenomenon. While, unsurprisingly, not articulating its guidance for the use of simulation exercises or Level 3 inputs for FVA explicitly in terms of simulacra, the contingency of simulation exercises has been a persistent, and troubling, issue for the FASB.

<sup>2</sup> Although the FASB recently codified U.S. GAAP, we continue to use the term FAS 157 throughout this paper as this citation format was in use during the process of modifying the standard.

<sup>3</sup> Hyperreality: “. . . the generation by models of a real without origins or reality: a hyperreal” (Baudrillard, 1983: 2).

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