Discussion of

Market Perceptions of the Informational and Comparability Effects of Fair Value Reporting for Tangible Assets: US and Cross-Country Evidence

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Summary

Investigates whether stock prices of investment property firms respond to events increasing the likelihood of fair value reporting for investment property in the US

Three key results:

1. Significant positive reaction for US firms
2. More positive reaction for firms with (i) big 4 auditors, (ii) high institutional ownership, (iii) cross-listing (iv) high exposure to international property, (v) staler assets, (vi) lower risk
3. Significant positive reaction for non-US firms

Nice Features of the Paper

1. Powerful setting for examining the impact of mandatory fair value disclosure requirements on stock prices
2. Strong results. Inferred market reaction of 4.3% for US firms and 3.2% for non-US firms.
3. Carefully executed study and well-written paper

Key Result

TABLE 4
Univariate analysis – US sample

Event	Date	Description	Predicted Market Reaction if: $FV_{benefits} > FV_{costs}$ ($FV_{benefits} < FV_{costs}$)	Raw Return	Market-Adjusted Return
1	March 10, 2010	FASB adds to its agenda the reporting of investment property at fair value	+ (–)	0.0049 ***	–0.0017 ***
2	July 22, 2010	FASB requires fair value measurement of investment properties	+ (–)	0.0356 ***	0.0121 ***
3	August 24, 2011	FASB clarifies the criteria for investment property entity	+ (–)	0.0171 ***	0.0062 ***
4	October 21, 2011	FASB issues the Exposure Draft requiring investment property be reported at fair value	+ (–)	0.0351 ***	0.0148 ***
5	August 8, 2012	FASB indicates lack of support for the Exposure Draft, and is now considering alternative approaches	– (+)	–0.0094 ***	–0.0100 ***
6	January 29, 2014	FASB removes the investment property topic from its agenda	– (+)	–0.0103 ***	–0.0019 ***
Mean Return Across Events					0.0072
t-statistic (versus 0)					2.799 **
t-statistic (versus 300)					2.192 *
p-value (bootstrap)					0.018 **

Opportunities for Improvement and Further Research

1. Would be very helpful to have a better understanding of the underlying costs and benefits
2. Net benefits seem economically large (4.3% of market cap.). Is this plausible?
3. Given the large net benefits, why did users and preparers lobby against the standard?
4. Reconcile the strong results of this paper with the mixed results of previous research

Detailing the Costs and Benefits

- Benefits described in the paper include reducing information asymmetry, providing more relevant information and enhancing comparability
- Costs include burdening investors with less reliable information and additional information preparation costs.
- Are benefits and costs economically significant?
  - NAV estimates are produced by analysts and made available by services such as SNL
  - Real estate values are primarily driven by location and comparables, which are widely available
  - Most property investment companies operate properties to generate rental income
  - Why don’t (more) investment property firms voluntarily disclose fair values?

Are Documented Net Benefits Implausibly Large?

- Did any press coverage attribute the increase in stock prices to the accounting proposals and/or did any analyst reports increase their price targets in response to the accounting proposals?
- Was there a similar reaction of non-US firms to adoption of IAS 40?
- Presumably the cumulative returns to a fully-fledged fair value model for property would be even larger?

Why Did Users/Preparers Lobby Against Proposal?

2011-210
Comment Letter No. 13A

CFA INSTITUTE

Summary of Our Position

1) We disagree with an entity-based & intent-based approach for measurement of investment properties specifically and real estate more broadly.
2) CFA Institute membership believes fair value is the most relevant measurement basis for investment properties.
3) The Proposed Update distracts stakeholders from the relevance of fair value for real estate across a broad spectrum of enterprises. Fair value is not only relevant for investment properties housed within investment property entities ("IPEs") as defined in the Proposed Update.
4) Recent examples – as analyzed in **Appendix I** – provide empirical evidence regarding the relevance of real estate fair values in the investment decision-making process across a broad spectrum of enterprises. The examples demonstrate that management intent and the nature of the entity owning the real estate do no alter the relevance of fair value information to investors. They also demonstrate that the lack of fair value information disadvantages shareholders.
5) Convergence objective has not been achieved. In fact, the Proposed Update will increase complexity and lack of comparability for investors. A high-quality solution as proposed below should be prioritized over convergence.

Reconcile with Previous Results

- There is mixed evidence of stock price responses to controversial fair-value-oriented accounting proposals
- One prominent example is expensing the fair value of employee stock option compensation (e.g., Dechow, Hutton and Sloan, 1996)
- Christensen and Nikolaev (2013) find that many non-US firms do dot elect to value non-financial assets at fair value
- Maybe some other information pertinent to investment property firms came out at the same time? Maybe that is why non-US firms went up so much?

Summing Up

- Nice study with intriguing results
- Results are strongly economically significant and suggest that there are substantial benefits to mandatory reporting of fair values
- But are they too good to be true?
- Given the user and preparer enthusiasm to move to a comprehensive fair value model, we should be able to conduct additional out-of-sample tests soon