Accounting for Financial Instruments: Difficulties with Fair Value Measurement

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ABSTRACT

Nowadays financial instruments are used extensively not only by financial institutions but also by industrial and service entities. However, the complete guidance for those instruments' accounting is yet to be developed. Under those circumstances, reporting entities encounter issues in regards to correct measurement of the value of those instruments. This paper identifies critical issues in this process by analyzing financial statements of an entity and gathering data from executives' of reporting entities operating in the Republic of Armenia.

Keywords: accounting and finance | financial instruments | accounting | convergence | fair value measurement

Subject Categories: Accounting | Finance and Financial Management

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All remaining errors, if any, are mine.

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1 - Introduction

The global interest in the correct accounting treatment of financial instruments has surged substantially because of several reasons. Firstly, the advancement of the use of financial instruments over the past decade has transcended the development of guides for their accounting. Financial statement users, such as investors, managers, and auditors have continuously had difficulties with accounting for financial instruments. Additionally, the financial instruments' substantial influence on the 2008 global financial crisis further highlighted that the current accounting standards for financial instruments are "inadequate for today's complex economic environment ("Focus" 2010). After the crisis hit, the Financial Crisis Inquiry Commission (hereinafter FCIC) held a number of hearings where it was determined that inability of reporting entities to recognize the declining fair value of derivatives and Credit Default Swaps (CDS) "substantially aggravated" the financial crisis (Alexopulos, 2010). Hence, two main accounting standards setting committees, the U.S. Financial Accounting Standards Board (hereinafter FASB) and the International Accounting Standards Board (hereinafter IASB) underlined the importance to come up with reliable standards and amendments for the Presentation, Recognition, Measurement, and Disclosures of Financial Instruments.

The research intended to identify whether there are any issues with the measurement of the fair value of financial instruments that financial officers encounter during the reporting of financial statements. The latter served as the primary goal of the research and the thesis project. The paper thoroughly discusses the current practices for the financial instruments' fair value measurement according to International Financial Reporting Standards (hereinafter IFRS). After that, by applying experimental and archival accounting research methods, this paper illustrates that two main difficulties identified were the following: the inability to apply volatile market

conditions in the fair value of the instrument and unnoticed impairment losses of financial instruments. The analysis examines both current accounting rules published by IASB for mainly European entities and regulations applicable to entities operating in the United States.

Fair value accounting can be evaluated only with a clear understanding of its features. Section 2 of the paper lays out main requirements and definitions applicable to grasp sufficient understanding of the main concepts. Thereafter, the Literature Review Section of the paper includes the convergence program between IASB and FASB on the issue of Financial Instruments and related works on the subject of the impact of fair value measurement on the firms' financial position. In Section 5, a business case of a Spain based commercial bank will be illustrated to identify the business specific difficulties of the fair value reporting. Those issues were determined by comparing year by year financial statements of the firm and external audit comments on the topic. In Section 6, cases will demonstrate how the entities measure the fair value of financial instruments within the normal course of the business and what are the pertaining issues that they encounter. Cases in the Section 6 were identified from the interviews with executives of the Armenian firms that either have a considerable amount of financial instruments in their balances or daily deal with those instruments.

1.1 - Definitions

Financial instrument - The International IFRS No 9 *Financial Instruments* issued by the International Accounting Standards Board defines financial instruments as "any contract that gives rise to both a financial asset of one and a financial liability or equity instrument of another entity".

Financial asset - Any asset that is: 1) Cash; 2) An equity instrument of another entity; 3) A contractual right to receive cash or another financial asset from another entity; or to exchange financial instruments with another entity under conditions that are potentially favorable to the entity. Examples include: trade receivables, options, shares (when held as an investment) and etc.

Financial liability - Any liability that is a contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial instruments with another entity under conditions that are potentially unfavorable. Examples include: trade payables, debenture loans payable, redeemable preference (non-equity) shares and etc.

Equity instrument - Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Examples include: mutual funds, money market mutual funds, reinvested earnings, common stock and etc.

Fair value - Price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Contract - An agreement that has 'clear economic consequences' and which the parties to it cannot avoid, usually because the agreement is enforceable in law.

1.2 - Current Accounting Standards for Financial Instruments

Four accounting standards deal with financial instruments.

IAS 32 Financial instruments: presentation - The standard deals with the classification of financial instruments between liabilities and equity, and the presentation of certain compound instruments combining debt and equity.

IFRS 9 Financial instruments - The standard deals with recognition and derecognition and the measurement of financial instruments. Started from January 1, 2013 this standard grade by grade replaces *IAS 39 Financial instruments: recognition and measurement.* Officially, the *IFRS 9 Financial instruments* has to be applied form January 1, 2018.

IFRS 7 Financial instruments: disclosure **-** The standard deals with the disclosure requirements of financial instruments.

The main concept behind the *IAS 32 Financial instruments: presentation* and *IFRS 9 Financial Instruments*, which apply to all financial instruments, is that financial instruments should be presented according to their substance, not merely their legal form. In other words, reporting entities should classify financial instruments as financial assets, liabilities, or equity. The entity recognizes financial asset/liability at the moment when it becomes party to the contractual provisions of the instrument. Notably, the probability of inflow or outflow of resources is not taken into account under those circumstances.

1.2.1 - Current Accounting Standards for Financial Asset Instruments

IFRS 9 Financial Instruments requires that financial assets to be measured at either amortized cost or fair value. Accordingly, a financial asset is classified as measured at amortized cost when the objective of the business model of holding assets is to collect contractual cash

flows that arise on specific dates. Other financial assets are classified as measured at the fair value, with gains and losses recognized in the Income Statement as profit or loss. Within the scope of this paper, only financial assets classified as measured at fair value will be evaluated.

IFRS 9 Financial Instruments differentiates two types of financial assets: Held to Maturity financial asset (hereinafter HTM) and Trading Security (hereinafter TS). An investment that is not intended to be actively traded, but the entity is willing to sell it when the market conditions are desirable, is considered an HTM security. In contrast, TS is a financial instrument that an entity acquires and intends to sell in a short duration (Nelson, Spiceland and Sepe, 2013). At the point of acquisition of the asset, the standard requires entities to apply test of the business model. *IFRS 9 Financial Instruments* introduces a business model test that requires an entity to assess whether its business objective for an instrument is to collect the contractual cash flows of the instrument as opposed to realizing any change in its fair value by selling it before its contractual maturity. The main difference between these two is the way how entities are required to account for unrealized gains and losses that arise throughout the life of the asset. For both types of assets, basic recognition procedure is to debit investment asset account in the statement of financial position and to credit cash or payables account. However, the purpose of TS is to profit from the short-term price changes, thus price fluctuations are analyzed on a day-to-day basis. If the value of the security falls/rises, the entity has to record an unrealized holding loss/gain. Once the TS is sold, gain/loss amount (the difference between carrying amount of the asset and the payment received) is transferred to Net Income, after that to Retained Earnings. The recognition procedure for HTMs is the same as it is for TSs, however, at the point of sale unrealized gains/losses are transferred to Other Comprehensive Income; this method intends to eliminate unnecessary fluctuations of the net income. In both cases, the entity should be able to

identify the fair value of the financial asset, so it will be able to illustrate the true and fair position of the firm.

1.2.2 - Current Accounting Standards for Financial Liability Instruments

As one can recall from the definition of financial liability, there is a contractual obligation to transfer economic benefit, in contrast to equity instruments. Even though the latter may be entitled to pro rata share of distributions out of equity, there is no binding obligation on the company to distribute dividends.

Financial liabilities include bonds, long-term notes, installment notes, accounts on credit, trade notes, currency and deposits, credit lines, noninterest-bearing notes, loans, commercial paper, and the debt portion of convertible loans/bonds. They can be long-term or short-term debt securities. Long-term liabilities are recorded in the balance sheet at their present value, which is the present value of the related cash flows discounted using the effective interest rate at the time of issuance (Nelson et.al, 2013). Similar to financial assets, financial liabilities are classified as measured at either fair value through profit or loss or at amortized cost. Within the scope of this paper, only financial liabilities classified as measured at fair value will be evaluated.

Initial measurement of financial liabilities is conducted via the fair value of the consideration. The latter normally is the transaction price or free market price. If market prices are not reliable, the fair value may be estimated using a valuation technique (e.g. discounting future cash flows). Once matured, unrealized gains/losses of the financial liability are transferred to net income.

1.2.3 - Current Accounting Standards for Financial Equity Instruments

After initial recognition equity instruments are measured at either fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVTOCI). If equity instruments are held at FVTPL no transaction costs are included in the carrying amount. Equity instruments can be held at FVTOCI if they are not held for trading (i.e. the intention is to hold them for the long term to collect dividend income). Within the scope of this paper only financial equities classified as measured at FVTPL will be evaluated on the example of common shares.

1.3 - Statement of the Thesis Question

Fair value accounting has been in the center of criticism after the 2008 global financial crisis. The most influential opponents of the fair value accounting are the investment and commercial bankers, insurance agencies and hedge funds that faced massive asset write-downs, because of the application of fair value accounting (Shaffer, 2011). However, the standard setters, the U.S. Securities and Exchange Commission (hereinafter SEC), FASB and IASB defend fair value accounting, blamed for exacerbating the global financial crisis, by pointing that fair value accounting has not caused the financial crisis but has been demonstrating the real situation of the companies.

By illustrating real-world business cases, this paper identifies issues that companies encounter while evaluating the fair value of financial instruments. The question is to determine are there any issues that reporting entities may face while preparing the financial statements.

2 - Literature Review

The motivation of the paper was the understanding that entities may encounter numerous business risks that may arise due to even slight variations in the methods of fair value estimation.

From the norms that IFR Standards on financial instruments require entities to implement, it is notable that fair value estimation is of high importance for financial reporting. Slight changes in the estimation methods may affect all five financial statements of the entity. These difficulties may eventually lead not only to errors but also to fraudulent activities. Started from the crisis of "dot-com bubble" during the first years of the 21st century, many companies were manipulating with the fair values of the financial assets they held. So, they would be able to overstate assets in the statement of financial position. It is also incredibly difficult to measure the fair value of financial instruments and to determine when the recognition of impairment losses is appropriate. The latter accounted for considerable losses during the 2008 global financial crisis, when investment banks were not able to identify the impairment of the assets they were holding. The paper by Sanders Shaffer on the topic of "Evaluating the Impact of Fair Value Accounting on Financial Institutions" illustrates that fair value measurement difficulties and the inability to detect impairment losses on time lead to a significant level of Capital and Earnings volatility (Shaffer, 2011). Besides the Capital and Earnings, Shaffer also illustrates the impact of the fair value accounting on assessment of the overall safety and soundness of a financial institution. He based the evaluation on six essential components of the firms' financial condition and operations: adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risk.

The literature review for this paper also included a thorough examination of the publications of standards by the IASB. All four IFR Standards that cover financial instruments were inspected to find the requirements for the fair value estimation. In addition to standards published by IASB, standards that include the requirements for the measurement and treatment of financial instruments in the United States published by FASB were also taken into

consideration. In this way, it would be possible to create the full picture of the fair value estimation requirements. In addition to standards, SEC and leading international accounting/assurance firms regularly publish commentaries on this topic: those publications were also included in the literature review of this project.

Started from the September of 2002, IASB and FASB formally started convergence program to come up with universal accounting standards that would be applicable internationally (IASB, 2012). However, many challenges are identified in every stage of the program. In this paper, comments and meeting drafts of this convergence program are used periodically, since they incorporate the ideas and concerns of both standard-setting boards.

In Section 5 of this paper, the analysis refers to the audit report of the entity to come up with pertaining difficulties that the entity encounters during the fair value measurement of the financial instruments. In order to understand the concerns of the external audit committee, the paper by Glover, Taylor, and Wu on the topic of " Current Practices and Challenges in Auditing Fair Value Measurements and Complex Estimates" is taken into consideration. The paper illustrates that external auditors should follow the fair value measurement practices applied by the entity. However, they should also implement analytical procedures to understand whether the entity's financial statements are significantly volatile in regards to fair value measurement issues (Glover et al., 2016). Within the scope of the evaluation, the paper uses International Standards on Auditing (ISAs) published by the International Auditing and Assurance Standards Board (IAASB). To illustrate the practices applied in the Republic of Armenia, publications by the Central Bank of Armenia, State Revenue Committee under the RA Government were used in addition to personal interviews conducted with the parties.

3 - Methodology

For this paper, experimental and archival accounting research methods were conducted. Archival accounting method incorporated data collection from published accounting sources (e.g. published data).

The first case study takes the financial statements and external audit opinion of the bank operating in Spain: Banco Bilbao Vizcaya and Argentaria (hereinafter BBVA). The decision to analyze this bank was that financial instruments account for a considerable amount of two sides of the balance sheet. Additionally, the bank in 2013 acquired EVO Banco and all the financial assets of the acquiree were revalued using the fair value estimates of the BBVA. According to the external audit report on the audit of BBVA, the bank regularly encounters fair value measurement challenges within the course of its operations. So, the issues with the fair value measurement identified by the bank and the external audit committee, that pertain for an extended period are designated as critical issues in the fair value measurement of financial instruments.

The qualitative research method in the form of the interviews was performed to recreate the business practices, for further analysis in this paper. Eight interviews were conducted for the second case. Interviewees were selected from the executives of firms operating in Armenia. Those firms were of two types: firms that have a considerable amount of financial instruments in their balance sheets (banks, credit agencies, pension funds) and firms that deal with financial instruments as a third party (audit and assurance firms). Taking into account the fact that all entities were using IFR Standards for their financial reporting, the results can be generalized for IFR Standards using entities. The survey questions for all eight interviewees were the same, with the key question being the following: "What are the three issues with the measurement of the fair

value of financial instruments that your entity encounters within the normal course of the business?" (For the list of questions and other data see Appendixes 3-5). Thereafter, those issues that were underlined by the majority of the interviewees were identified as key pertaining challenges for the fair value measurement.

The limitation of this dataset is that it only includes representatives of the firms operating in the Republic of Armenia. However, four out of eight entities represent branches of international organizations, and interviewees have expertise in international firms.

4 - Analysis and Results: Case Study of BBVA

The business case within the regular course of operations will be illustrated on the example of financial statements (with accompanying notes) of the commercial bank: Banco Bilbao Vizcaya Argentaria. The latter is a multinational Spanish banking group, which was formed from a merger of Banco Bilbao Vizcaya and Argentaria (hereinafter BBVA) in 1999(BBVA Annual Report, 2017).

Since financial instruments account for considerable part of the statement of financial position of the bank, a separate section of the balance sheet with accompanying notes was dedicated to this part (see Appendix 1). It is important to note, that legally, financial institutions in Spain are required to conduct the external audit after each fiscal year. After the end of 2017 fiscal year, the external audit (conducted by KPMG Spain) concluded that the financial statements of BBVA give the true and fair representation of the financial position of the firm. Given the latter fact, I assume that those financial statements and notes can be used for the analysis. For the 2017 fiscal year, BBVA reported financial assets (both carried at amortized cost and fair value) in the amount of 590 b Euros (out of those, financial assets carried at fair value

amount to 312.5 b Euros). It also reported financial liabilities in the amount of 568 b Euros (out of those, TS Debt securities carried at fair value amount to 117 b Euros). The latter means that even slight changes in the estimates of the fair value may affect the position of the firm substantially.

I can see from the notes to the financial statements that approximately 34% of financial assets and 42% of financial liabilities classified at the fair value are being reclassified and remeasured for possible impairment losses. According to the standard, these figures should be in the range of 5-10% given standard conditions of the market (Shaffer, 2011). This fact clearly points that BBVA encounters issues with the requirements of the fair value measurement of financial instruments. Additionally, in 2017 annual report of the BBVA, the Chief Financial Officer Jaime Sáenz de Tejada underlined that BBVA regularly encounters issues with the requirement of the fair value reporting and hopes that the convergence program between two standard-setting boards will eventually come up with a satisfying solution for everyone (BBVA Annual Report, 2016).

Looking to notes of financial statements for the years 2015-2017 and the reports of external audit for these years I was able to identify issues that the BBVA encountered. I can observe that BBVA applied the basic present-value method to determine the fair value of common financial instruments (e.g. non-coupon bonds, preferred shares, etc.). However, the discount rate applied was slightly higher than the cost of capital of the firm mentioned in the 2017 annual report. This key difference is also referred by the 2017 external audit report (KPMG on BBVA, 2017). The external audit committee underlines that some part of financial instruments held in the form of European governmental bonds can be of high volatility and subject to soon defaults. The usage of higher interest rate will keep the company on the safe side

if the default happens. So, the above-mentioned points lead to the understanding that one of the main issues in the fair value measurement is that sometimes it does not reflect the real economic value of the instrument. For the BBVA, the latter problem forces it to apply safer discount rate. In this case, it may undervalue its financial assets held in the form of non-coupon bonds, because it uses higher discount rate for the present value of cash flows.

From the financial statements of the firm, I was able to observe that BBVA applies multiple discounting models for every group of financial instruments. It was clear that Analytic/semi-analytic judgment, Monte Carlo Simulation, Black-Derman-Toy Model and Libor Market Model are used in the evaluation of more valuable instruments. In parallel with implementing several models, the company eliminates the model subjectivity risk of the fair value, which might have distorted the real fair value of the instrument. The reason for applying extensive valuation techniques is that the firm encountered considerable impairment losses during the peak of Spanish Crisis in 2012. At the time the models did not illustrate the future impairment losses. The inability to detect impairment losses is also underlined by the KPMG audit opinion for the year 2015 (KPMG on BBVA, 2015). From this, I can conclude that undetected impairment losses are another essential challenge that entities encounter during the fair value measurement of the financial instruments.

5 - Analysis and Results: Interviews with Reporting Entities' Executives

The interviewees were selected from the executives of the entities operating in the Republic of Armenia that either hold a significant amount of financial instruments in their balances or audit those entities. Additionally, all the selected entities have applied IFR Standards and RA Tax Code in their operations (See Appendix 3). The interviews included reporting

entities in the face of two commercial banks and a pension fund (Type 1). Executives from audit and assurance firms were also invited, so the perspective of the external audit could be taken into account (Type 2). Even with the limitations of this dataset, I assume that the data gathered from this source is sufficient to answer the thesis question and get main findings of the research.

Before getting to the central interview question, the first question was whether the entity(or entities audited) encounter issues with regards to the fair value measurement of the financial instruments. The second question followed: Are those issues remained significant for more than one reporting period? All interviewees answered "Yes" to those questions (See Appendix 5.1). The latter finding leads to a conclusion that entities dealing with financial instruments do encounter issues that are of high importance since those repeat periodically. This findings created sufficient grounds to continue the research with those subjects and further generalize the results.

The third and the main question was "What are the issues that your entity (or entity audited) encounters during the fair value measurement of financial instruments?". Answers followed varied in complexity and diversity. However, the main idea that was possible to detect from answers of all executives was that the fair value of the financial instruments has to reflect even the volatile market conditions of the instrument. Hence, the latter is difficult to incorporate in the fair value because of several issues. Mr. David Sargsyan mentioned that subjectivity of the fair value measurement is due to the impact of human judgment (Sargsyan, 2018). However, those issues are outside of the scope of this paper.

In line with the market volatility, the impairment losses are inevitable and usually are not detected in time by the reporting entities. Mr. Manuk Grigoryan outlined that impairment check-

ups of financial instruments require hard efforts from the reporting entities, while some of them fail to meet those requirements. This kind of negligence eventually leads to impairment losses (Grigoryan, 2018). In other cases, the entities recognize unrealized gains/losses in wrong accounts, thus distorting the true and fair picture of the financial position of the firm (Hovhannisyan, 2017).

Obviously, interviewees pointed out other essential issues with regards to the fair value measurement. However, those issues were either detected solely by one entity or were short-term not lasting for longer than one reporting period.

6 - Conclusion and Final Comments

The findings from the case study of BBVA and entities operating in the Republic of Armenia go in line with each other. The thesis question of the paper is answered within the scope of this research: there are issues with the fair value measurement of financial instruments. Additionally, two case studies illustrated that two main challenges that entities encounter during this process are the inability to apply volatile market conditions in the fair value of the instruments and undetected impairment losses that entities encounter due to the fair value measurement.

The further research on this topic may include more diverse and random sample size for the conduction of interviews from reporting entities. The study may go further in the determination of techniques that entities may apply to overcome the issues with regards to the fair value measurement.

This study is subject to limitations. First, I gather executives' views from firms operating in the Republic of Armenia and a case study of Spain based commercial bank. Thus, results may not reflect practices and challenges encountered in smaller firms. Despite this, the study provides valuable insights regarding current problems faced when measuring the fair value of financial instruments.

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8 - Appendix

Appendix 1 - Fair Value and Carrying Value of Financial Instruments of BBVA for years 2015-2017

		Millions of Euros					
		2017		2016		2015	
Fair Value and Carrying Amount	Notes	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
ASSETS-							
Cash and balances with central banks	9	37,434	37,434	30,939	30,939	19,981	19,981
Financial assets held for trading	10	79,954	79,954	70,602	70,602	63,283	63,283
Other financial assets designated at fair value through profit or loss	11	2,853	2,853	2,977	2,977	2,774	2,774
Available-for-sale financial assets	12	71,500	71,500	58,144	58,144	56,456	56,456
Loans and receivables	13	383,410	403,606	381,076	389,204	364,707	371,359
Held-to-maturity investments	14	10,162	9,860	10,955	10,190	9,946	9,189
Fair value changes of the hedges items in portfolio hedges of interest rate risk	15	226	226	146	146	40	40
Hedging derivatives	15	4,894	4,894	4,552	4,552	3,563	3,563
LIABILITIES-							
Financial assets held for trading	10	55,927	55,927	51,303	51,303	37,212	37,212
Other financial liabilities designated at fair value through profit or loss	11	2,516	2,516	1,825	1,825	1,607	1,607
Financial liabilities at amortized cost	23	506,487	504,267	479,904	473,886	453,164	453,504
Fair value changes of the hedged items in portfolio hedges of interest rate risk.	15	-	-	-	-	(2)	(2)
Hedging derivatives	15	2,968	2,968	2,710	2,710	1,664	1,664

Appendix 2 - Fair Value of financial instruments of BBVA for years 2015-2017 by internally designated level

						Millions of Euros				
			2017			2016			2015	
Fair Value by Levels	Notes	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
ASSETS-										
Financial assets held for trading	10	30,944	48,598	412	22,986	46,915	700	28,914	33,568	802
Loans and advances to customers		244	-	-	-	-	-	-	-	-
Debt securities		27,053	718	295	19,731	793	451	22,930	921	508
Equity instruments		2,713	140	70	2,033	97	68	5,034	92	134
Trading derivatives		934	47,740	47	1,222	46,025	182	950	32,555	160
Other financial assets designated at fair value through profit or loss	11	2,768	86	-	2,358	619	-	2,326	448	-
Loans and advances to credit institutions		-	24	-	-	-	-	-	-	-
Debt securities		692	62	-	647	61	-	624	64	-
Equity instruments		2,076	-	-	1,711	558	-	1,702	384	-
Available-for-sale financial assets	12	51,682	18,551	757	41,286	15,249	1,067	41,500	13,789	668
Debt securities		48,484	18,359	700	37,286	15,025	602	37,024	13,352	499
Equity instruments		3,198	192	57	4,000	224	465	4,476	437	169
Hedging derivatives	15	111	4,784	-	289	4,263	-	265	3,298	-
LIABILITIES-										
Financial liabilities held for trading	10	7,371	48,519	38	5,813	45,467	23	4,961	32,225	25
Trading derivatives		791	48,519	38	1,202	45,467	23	916	32,225	25
Short positions		6,580	-	-	4,611	-	-	4,046	-	-
Other financial liabilities designated at fair value through profit or loss	11	-	2,516	-	-	1,825	-	-	1,607	-
Hedging derivatives	15	-	2,951	17	-	2,710	-	96	1,568	-

Appendix 3 - Information on interviews held

Name of the interviewee	Organization/Institution	Type of the institution*	Position	Date of the interview - dd/mm/yyyy	Method of the interview
David Sargsyan	1)ArdshinBank Armenia, 2)AUA	1	1) Chief Financial Officer, 2) Lecturer	11.04.2018	Personal
Izabella Adilkhanyan	1) C-QUADRAT Ampega Asset Management Armenia, 2) AUA	1	1) Chief Financial and Operations Officer, 2)Lecturer	25.12.2017	Personal
Tigran Galstyan	AraratBank Armenia	1	Chief Accountant	24.04.2018	Personal
Karen Hovhannisyan	Global Credit UCO	1	Chief Operations Officer	25.04.2018	Personal
Hrachya Hovhannisyan	1) BDO Armenia, 2) AUA	2	1) Head of Audit and Related Services, 2)Lecturer	10.05.2017	Personal
Manuk Grigoryan	Grant Thornton Armenia	2	Senior Manager	02.05.2018	Skype - Typing
Marina Yengibaryan	1) Deloitte Armenia, 2) AUA	2	1) Senior Manager, 2)Lecturer	10.04.2017	Personal
David Ananyan	Ministry of Finance of RA	3	Deputy Minister as of 08.05.2018	01.05.2018	Phone

* I differentiate 3 types of institutions for the evaluation in this paper. Type 1 - Entities that hold financial instruments in their balances. Type 2 - Entities that check and audit balances of other entities that may carry financial instruments in their balances. Type 3 - Regulatory Body. Interview questions for David Ananyan were different from those asked to remaining interviewees. That interview was intended to get understanding of the concerns of the Regulatory bodies on the topic of fair value accounting.

Appendix 4 - Key questions discussed during interviews

Three main questions were the same for all interviewees

1) What do you think are there any issues with the fair value measurement of financial instruments in regards to *IFRS 9 Financial Instruments*?

2) Are those issues remained significant for more than one reporting period?

3) If yes, what are the issues that your entity (or entity audited) encounters during the fair value measurement of financial instruments?

Appendix 5 - Answers to interview questions 1 & 2

Name of the interviewee	Answer to Q1	Answer to Q2
David Sargsyan	Yes	Yes
Izabella Adilkhanyan	Yes	Yes
Tigran Galstyan	Yes	Yes
Karen Hovhannisyan	Yes	Yes
Hrachya Hovhannisyan	Yes	Yes
Manuk Grigoryan	Yes	Yes
Grigor Hambardzumyan	Yes	Yes
Total	**100% - Yes**	**100% - Yes**

Appendix 5.1 Answers to interview question 3

Answers of the question are summarized and translated from Armenian; those answers are not direct quotations.

David Sargsyan - 1) Fair value measurement is subject to constraints in regards to human judgment. 2) Predefined fair value measurement techniques may become obsolete and miss the real fair value of the instrument.

Izabella Adilkhanyan - 1) Fair value should be affected by the location and condition of the financial asset/liability however it is sometimes difficult to incorporate those measures in the value of the instrument. 2) Owning financial instruments from different parts of the world leads

to inconsistencies in the fair value measurement, and thus changes in the value are not always noticed.

Tigran Galstyan - 1) The fair value of the financial instrument should reflect the market conditions, however it is subjective to the reporting entity and may eventually lead to fraud or error in the financial statements. 2) Having in mind the previous point, it eventually leads to losses for entities.

Hrachya Hovhannisyan - 1) Audited entities report impairment losses or unrealized gains in wrong accounts, thus distorting the true and fair representation of the financial statements. 2) Impairment losses happen due to negligence of the financial officers, since Trading Securities require day-to-day follow-ups.

Manuk Grigoryan - 1) Fair value of financial instruments has to reflect the market conditions, however those are subject to human judgments, and thus may not reflect the real conditions of the financial instruments. 2) The check-ups of the conditions of financial instruments usually require hard efforts from entities; those efforts are not usually applied, thus leading to impairment losses.

Marina Yengibaryan - 1) Some audited entities being at the liquidation process, were valuing financial instruments as if they were in a going concern condition. 2) The entities encounter issues with the test of business model that IFRS requires to apply.