IJAAF; Vol. 7, No. 1, Winter 2023, Serial 22

Ferdowsi University of Mashhad

Iranian Journal of
Accounting, Auditing & Finance

Quarterly

RESEARCH ARTICLE

Incompatibilities of Using the IFRS Fair Value Basis in the Iranian Banking Business Framework

Elias Badri*
Financial markets department, Monetary and Banking Research Institute, Tehran, Iran
Ahmad Badri
Management and Accounting, Shahid Beheshti University, Tehran, Iran

How to cite this article:
Badri, E., & Badri, A. (2023). Incompatibilities of Using the IFRS Fair Value Basis in the Iranian Banking Business Framework. Iranian Journal of Accounting, Auditing and Finance, 7(1), 39-51. doi: 10.22067/ijaaf.2023.42355.1131
https://ijaaf.um.ac.ir/article_42355.html

ARTICLE INFO

Article History
Received: 2022-11-12
Accepted: 2022-12-25
Published online: 2023-01-20

Keywords: Fair Value, IFRS, Iranian Banking Business, Legal Structure, Policy Structure, Managerial Structure

Abstract

Fair value is one of the primary measurement basis in IFRS, especially for financial instruments. Since this measurement basis is derived from market logic, it can only work correctly if the business of the financial reporting unit is also consistent with this logic. The Banking business model as a financial intermediary is attracting resources and allocating them to resource applicants. This study investigates the compatibility of Iranian banking business with the fair value measurement logic described in IFRS. Our research methodology includes; a systematic review of IFRS Standards, literature, global experiences of implementing fair value, and a questionnaire (including 4 topics and 28 questions). We sent the questionnaire to four groups of respondents, including banks, Independent auditors of banks, supervisory institutions, academic experts and researchers, to collect Professional perspectives and opinions. Finally, we analyzed responses to our questionnaire (with a 90% rate of return) using a fuzzy logic method. Findings indicate that the banking business framework in Iran is influenced by three main factors: legal, policy, and managerial structure. Each of these factors imposes restrictions on the banking business, creating a deep gap between market logic and what runs in Iran's banking business. Therefore, the possibility and quality of fair value implementation in the financial reporting of Iran's banking industry will depend on when and how to fill this gap.

https://doi.org/10.22067/ijaaf.2023.42355.1131

NUMBER OF REFERENCES
12

NUMBER OF FIGURES
-

NUMBER OF TABLES
5

Homepage: https://ijaaf.um.ac.ir
E-Issn: 2588-6142
P-Issn: 2717-4131

*Corresponding Author: Elias Badri
Email: elyas.badri@gmail.com
Tel: 09126433302
ORCID:

1. Introduction

The mission of the IFRS Foundation is to create a common language of financial reporting that can provide transparency, accountability, and efficiency, ultimately contributing to economic stability and sustainable growth. One of these standards' main and distinctive features is the widespread use of the fair value basis. Since this measurement method is market-based, it inherently can provide two primary characteristics of helpful information: relevance and faithful representation. But the catch is that this basis has a mirror property and shows the information and logic of the market as it exists. Therefore, any problems and inefficiencies in the economy and markets are reflected in this measurement basis. The nature and extent of these problems can undermine the implementation process and make fair-value information meaningless.

In this study, we investigate the most fundamental aspect of these problems in the banking industry: Iran's Money market characteristics and banking business framework.

Fair valuation aims to reflect economic realities so that the most relevant and reliable information can be used for economic decisions. For fair value to work correctly in the banking industry, the business of banks and the money market characteristics should be aligned with a market-based logic. Therefore, this study solely focuses on analyzing the compatibility of the banking business framework in Iran and fair value reporting.

Other factors influencing the quality of fair value implementation are other issues such as information technology infrastructures, knowledge and expertise, supervision, quality of external audit, and valuation services. These challenges and weaknesses should also be studied, solved, and upgraded based on a roadmap in a reasonable amount of time.

2. Review of Research Background

This section is dedicated to reviewing what fair value is, what are its critical requirements in IFRS, What is the scope of its use in the banking industry, what is the goal and logic behind using fair value accounting, and finally, what are the attributes of banking business framework in Iran as host for implementing fair value accounting.

2.1. Fair value measurement and critical requirements in IFRS

In preparing financial statements, the measurement of accounting elements is one crucial factor that must not be overlooked as it determines how fairly the economic activity of organizations will be presented. The conventional accounting system supports recording assets and liabilities in the financial statement at the original cost. This method, referred to as historical cost, possesses some advantages, some of which include: objectivity, reliability, verifiability, and freedom from management bias (Shamkuts, 2010). It has been criticised for being unsuitable for making economic decisions and for its outdated cost figures reflecting outdated market conditions and expectations (Poon, 2004). These disadvantages led to the introduction of Fair Value, which, as far as the measurement of the financial statement is concerned, is considered the most useful market characteristic as it is presumed to provide information that is relevant to decision-making (Barth and Landsman, 1995, Beatty et al. 1996, Heaton et al. 2009). IFRS13 was introduced In 2011, which represents the culmination of a convergence project carried out by IASB and FASB. These two accounting standard setters were said to have achieved their aim of having a single global accounting standard for measuring fair value (Thornton, 2011).

IFRS13 defines fair value as "the 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" (IFRS13 paragraph 9). Key fair value measurement requirements have been reviewed in table 1.

Table 1. The Summary of key fair value measurement requirements in ifrs13

Fair value approach	Fair value is a market-based measurement, not an entity-specific measurement. Its' an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability.
Unobservable market data/ valuation techniques	When an identical asset or liability price is not observable, an entity measures fair value using a valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.
characteristics of the asset or liability	When measuring fair value, an entity shall consider all the characteristics of the asset or liability that market participants would consider when pricing the asset or liability at the measurement date.
The transaction	A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions. This is not a forced transaction (e.g. a forced liquidation or distress sale).
Market participants	market participants act in their economic best interests. They are considered independent, knowledgeable, able, and willing to enter a transaction.
Fair value at initial recognition	When an asset is acquired, or liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price).
Fair value levels	Level 1 inputs: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. Level 2 inputs: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs: Unobservable inputs for the asset or liability.
components of a present value measurement	A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date: Estimate future cash flows, expectations about possible variations in the amount and timing of the cash flows, time value of money, risk premium and other factors that market participants would consider.
Risk premium	As a component of present value measurement, the risk premium is the price for bearing the uncertainty inherent in the cash flows. A fair value measurement should include a risk premium reflecting the amount the market participant would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is insufficient to exclude a risk premium.
Scope	IFRS13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements.

There are far more requirements and details in ifrs13 about how to measure and disclose fair values. Still, here we focused on the essential requirements that explain the logic of fair valuation in order to compare it to the logic of the implementation environment.

2.2. Scope of fair value in the banking industry

The bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans. It also can have investments in financial instruments such as equities, bonds, derivatives, etc. in fact, we can say that the Main aspect of the banking business is the management of financial assets and liabilities, so because of the nature of the banking business, key items on the financial statements of the banks are financial instruments (Mostly deposits and loans). On the other hand, the main basis for measuring and disclosing financial instruments in IFRS

is fair value. Therefore, to examine the compatibility of fair value and Iranian banking business, we focus on the treatment of financial instruments (IFRS9 and IFRS7) in the financial reporting of banks.

Table 2. The Key requirements in ifrs9 addressing fair value measurement

Classification / subsequent measurement	Financial instruments are subsequently measured at amortised cost, fair value through other comprehensive income, or fair value through profit or loss. It's based on the entity's business model and the contractual cash flow characteristics, and it will be tested as follow: (a) the financial asset is held within a business model whose objective is achieved by: Collecting cash flows and selling financial assets, both collecting contractual cash flows and selling financial assets. (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Also, there is an irrevocable option to measure financial instruments at their fair value, but only if it provides more relevant information, eliminating inconsistency and accounting mismatches (FVO: fair value option).
Basic lending arrangement	Contractual cash flows, principal payments and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest. However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.
principal and interest	The principal is the fair value of the financial asset at initial recognition. The most significant elements of interest are typical considerations for the time value of money and credit risk. Interest can also consider other primary lending risks, costs, and profit margins (for example, liquidity risk and administrative costs).
Time value of money	The time value of money is the element of interest that provides consideration for only the passage of time. In some cases, the time value of the money element may be modified (i.e. imperfect), for example, if a financial asset's interest rate is periodically reset. Still, the frequency of that reset does not match the tenor of the interest rate. The entity may be able to make that determination by performing a qualitative assessment of the time value of the money element, whereas, in other circumstances, it may be necessary to perform a quantitative assessment.[1] In some jurisdictions, the government or a regulatory authority sets interest rates.[2] In some of these cases, the objective of the time value of the money element is not to provide consideration for only the passage of time. However, a regulated interest rate shall be considered a proxy for the time value of the money element for applying the conditions in the SPPI test if the regulated interest rate provides consideration that is broadly consistent with time and does not impose exposure to risks or volatility in the contractual cash flows which would be inconsistent with a basic lending arrangement.
Credit risk	The risk is that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.[3]
Initial measurement	At initial recognition, an entity shall measure a financial asset or financial liability at its fair value. Suppose an entity originates a loan that bears an off-market interest rate (e.g. 5 percent when the market rate for similar loans is 8 percent) and receives an upfront fee as compensation. In that case, the entity recognises the loan at its fair value, i.e. net of the fee it receives.

1- When assessing a modified time value of money element, the objective is to determine how different the contractual cash flows could be from the cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). If an entity concludes that the contractual cash flows could be significantly different from the benchmark cash flows, the financial asset does not meet the conditions in business model and sppi test and therefore cannot be measured at amortised cost or fair value through other comprehensive income.

2- For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy.

3- The credit risk for a collateralized liability may be close to zero.

Long-term loan or receivable	The fair value of a loan can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to the currency, term, type of interest rate, and other factors) with a similar credit rating.
Investments in equity instruments	All investments in equity instruments and contracts on those instruments must be measured at fair value[1].
Write-off	Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset. It expects to recover no more than %30(fair value of the collateral) of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining %70 of the financial asset.

Table 3. The Key requirements in ifrs7 about the fair value of financial instruments

Fair value disclosure of financial instruments	For each class of financial assets and liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount. Except for: (a) When the carrying amount is a reasonable approximation of fair value. (b) Insurance contracts (ifrs4) and (c) Lease liabilities.
Market risk	The risk is that a financial instrument's fair value or future cash flows will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risks.
Currency risk	The risk is that a financial instrument's fair value or future cash flows will fluctuate because of changes in foreign exchange rates.
Interest rate risk	The risk is that a financial instrument's fair value or future cash flows will fluctuate because of changes in market interest rates.

There are much more details and examples in the standards (ifrs9 and ifrs7). Still, this summary would be enough to explain the requirements of using the fair value for financial instruments, especially requirements that can be attributed to loans as a primary item on a bank's statement of financial position. Also, we didn't mention derivatives and hedge accounting matters here as it does not have much application in Iran's banking industry.

2.3. The goal of fair valuation

The logic of fair valuation is that every feature and aspect of an asset or a liability that the market perceives as a pricing factor should be considered. Cost of funds, compensations for risks, and a target profit margin are basic elements of loan pricing. No logical person is going to buy a financial instrument with more exposure to risk (inflation, market risk, credit risk, etc.) at a price of an instrument with lesser exposure to risk[2]. All these factors should be measured and presented properly for fair value information to be relevant and reliable for making informed financial decisions. This could improve the quality of financial reporting and transparency, especially for banking businesses with financial instruments strongly influenced by various risks.

Shareholders demand accounting information mostly for two purposes:

Valuation, Shareholders use accounting information to assess the (fair) value of the equity: What is equity stake worth?

Stewardship, Shareholders use accounting information to assess management's stewardship as the owners' employees: How efficient have managers been in making investments and conducting operations to add value to equity stake?

Fair value reporting based on a true economic market can provide data for assessing these questions.

1- in limited and rare circumstances, cost may be an appropriate estimate of fair value.
2- Assuming other factors are equal.

The main requirement of any financial statement is that it gives a true and fair view of the institution's financial position. Fair valuation does this by relying on market logic. It reflects market interpretations of financial information like a mirror. So if we look at fair valuation as a tool for financial reporting, its performance will be strongly influenced by the characteristics of the market and the mechanism that governs the businesses in that market.

Therefore, if, for any reason, the market approach is not economical or the business criteria are not aligned with the economic interests of the banks, the use of fair value will not reveal the economic facts. In such situations, fair valuation reporting can even become a platform for producing misleading information. That is why we focus on extracting factors arising from Iran's banking business framework incompatible with fair valuation as intended by IFRS.

2.4. Banking business framework in Iran and the affecting factors

The government in Iran has a large volume of holding activities carried out through companies, banks, government-affiliated institutions, and public, and non-governmental organizations, so the size of the public sector is very different from the size of the central and the public government. In addition, the size of the public sector in Iran is significantly different from that in other countries. In addition to government size, another factor is a measure of government intervention in the economy through legislation and regulations; in other words, non-budgetary government interventions affect the economy. Also, Iran, as an Islamic nation, has its sets of religious rules for its economic operation and mostly on its banking system, making it unique. Our goal here is to map these affecting factors on Iran's banking business framework through legal structure, policy settings structure, and managerial structure of banks and extract characteristics that may not be compatible with the logic of using fair value accounting in financial reporting of Iran's banking industry.

a) Legal structure

The legal structure governing the banking industry in Iran is based on the Riba-free banking operations law (Approved 1990, Adjusted 1990). This law has two main rules which make it completely different from conventional banking. First, the use of interest -as it is done in conventional international banking- is considered usury and is forbidden. Second, the relationship between the bank and the depositor, on the one hand, and the bank and the applicant of the bank funds, on the other hand, is not a creditor-debtor relationship. Originally, the concept set out in the law was profit-loss sharing (PLS). Still, in the real banking operation, with the addition of regulations by the central bank of Iran and the Money and Credit Council, it changed to something different that can not be categorized as either Riba-free banking or conventional banking. As discussed in the first part of the Research Background in the form of standard requirements outlines, these features can create challenges for implementing fair value. For example, interest (including the time value of money and credit risk) is essential in a basic lending arrangement as required by standards. This goes the same for the banking product characteristics which are, first, different from conventional banking and should not be treated as such according to standards, and secondly, it creates an opaque environment for what are the actual features of these products.

Another important difference in Iran's legal structure is that the Money and Credit Council sets rates for banking products that can contribute to widespread governmental intervention in the money market, which is usually not aligned with market logic. Hence, these legal structure bases could cause a large portion of the inconsistencies in implementing fair value in the banking industry of Iran.

b) Policy setting structure

The policy-setting structure is based on the legal structure and cannot be considered independent

of the legal structure. It is a legal structure that allows the policy setting to develop. For example, the position of the Monetary and Credit Council in legal structure to set banking product rates, in addition to its lack of independence from the government, can lead the policy setting of this council to be in the direction of government policies rather than economic logic.

Policy settings such as price control, Mandatory obligations for banks to make loans, governmental and semi-governmental shareholding dominance in the banking system and Instability in making these policies can undermine market efficiency, risk management, pricing, and hence, the fair value of the bank assets and liabilities. These policies contradict major fair value assumptions and requirements in standards such as free-market logic, market participants' characteristics, orderly transaction, etc. Therefore Policy setting structure could also cause inconsistencies in the implementation of fair value.

c) Managerial structure

As said before, Iran's banking industry is mostly run by governmental and quasi-governmental entities. This means that the managerial structure in the banking sector converges with government policies. Government policies do not prioritize the economics of the bank as an entity over its policies. Therefore, in this circumstance, the bank management does not necessarily act in the economic interests of the bank. Acting on the best economic benefits of the business unit is a crucial assumption of free-market logic, and this could undermine the quality of fair value implementation in the banking industry.

3. Research Methodology

After a systematic review, our survey used a questionnaire to collect data. The questionnaire design, submission, collection, and analysis of information took more than a year to be completed. The questionnaire was designed in the form of a colored booklet for the optimization of pages and the facilitation of reading. Also, a guide was provided to remove any ambiguity from the respondents.

Table 4. The questionnaire's status

Respondents	The number of questionnaires sent	The number of questionnaires received	rate of return	Response structure
Banks	32	29	91	Group
Independent auditors of banks	18	14	78	Group
Central Bank supervision	12	12	100	Group
Other supervisory bodies[1]	4	3	75	Group
Audit organization	3	3	100	Group
Academic experts and researchers	50	45	90	Individual
Total	119	106	90	-

Fuzzy statistics is the technical knowledge of examining inaccurate values and performing statistical tests based on inaccurate and general hypotheses.

In General, for analysis of questionnaires, well-known membership functions such as triangular, trapezoidal, and curved membership functions have been used. In this research, we used the triangular membership function. To increase accuracy and convenience in questionnaire design, we assumed semi-fuzzy elements between 0 to 10 for all objects (individuals and groups of respondents); also, we chose simple bound (± 1) to create fuzzy data from semi-fuzzy data as formula (1)

1 Association of certified public accountant, Stock Exchange and Securities Organization, Justice Experts' Association

$$(x_{a-1}, x_a, x_{a+1}) \quad (1)$$

Therefore, the membership function formula is as follows: (2)

$$\begin{cases} 0 & x < a-1 \\ x-a+1 & a-1 \le x < a \\ 1 & x = a \\ -x+a+1 & a < x \le a+1 \\ 0 & x > a+1 \end{cases} \quad (2)$$

According to the data type, questions and questionnaire type, the following process has been taken to perform the test on the hypothesis.

After reviewing the appearance and logic of the questionnaires, entering the data in a spreadsheet work page, and categorizing them, we wrote and developed R codes that go through the following process. First, it calculates sufficient statistics related to each question as formula (3):

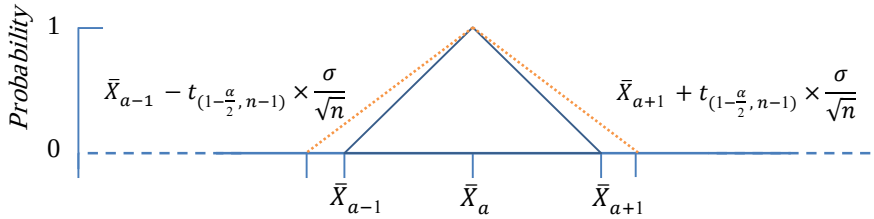
$$\bar{X}_{Fuzzy} = \left(n^{-1} \times \sum_{n=1}^{n} (x-1), n^{-1} \times \sum_{n=1}^{n} (x), n^{-1} \times \sum_{n=1}^{n} (x+1) \right) \quad (3)$$

Which is summarized as:

$$\bar{X}_{Fuzzy} = (\bar{X}_{a-1}, \bar{X}_a, \bar{X}_{a+2}) \quad (4)$$

to perform the hypothesis test, we have to find the confidence interval at$(1-\alpha)\%$ So we used from t student distribution quantiles. Then we define and plot a 95% confidence zone diagram according to formula (5) to create hypothesis tests.

Figure confidence zone



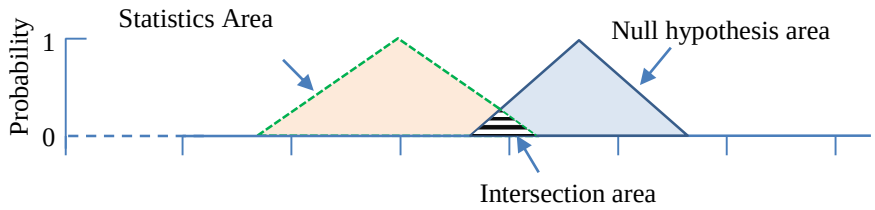
Formula (4) shows a confident zone at 95% confidence based on the t student distribution quantile, in which expression at the right is the upper limit in 95% for $\underline{X}_{a+1}$ and expression at the left is the lower limit of 95% for $\underline{X}_{a-1}$.

$$\left(\bar{X}_{a-1} - t_{\left(1-\frac{\alpha}{2}, n-1\right)} \times \frac{1}{\sqrt{n}}, \quad \bar{X}_{a+1} + t_{\left(1-\frac{\alpha}{2}, n-1\right)} \times \frac{1}{\sqrt{n}} \right) \quad (5)$$

We fuzzed statistics and Null hypothesis values to perform the test, calculated the p-value according to formula (2), and then calculated the Intersection area. The ratio of the Intersection area to the hypothesis area is defined as the p-value.

Like the classical hypotheses, if P-value $< \alpha$, then the Null hypothesis will be rejected, which means that the two sets are not the same; otherwise Null hypothesis is accepted.

P-value diagram



After performing the statistical test, the TOPSIS technique is applied to rank all questions, and we expect the most important questions to get a higher score and take a lower rank, and rejected assumptions to get the lowest scores and take place at the bottom of the rankings.

Research Question

What are the incompatibilities of using the IFRS fair value basis in the Iranian banking business framework?

4. Results and Discussion

Topic (1): what are Legal structure factors affecting the implementation of fair value in Iran's banking industry?

This question investigates the legal structure factors that complicate fair value implementation in Iran's banking industry. The purpose of this question is to identify which legal structure aspects are not consistent with what is required in the standards about how and when to measure and report fair values across different items in the financial reporting of banks. The statistical tests of hypothetical factors are presented in Table 3.

Topic (2): what are Policy setting structure factors affecting the implementation of fair value in Iran's banking industry?

This question investigates the Policy setting structure factors that make fair value implementation in Iran's banking industry inconvenient. The purpose of this question is to identify policy-setting attributes that are not consistent with what is required in the standards about how and when to measure and report fair values across different items in the financial reporting of banks. The statistical tests of hypothetical factors are presented in Table 3.

Topic (3): what are Managerial structure factors affecting the implementation of fair value in Iran's banking industry?

This question investigates the bank's managerial structure factors that make implementing fair value in Iran's banking industry inconvenient. This question aims to identify managerial attributes that undermine measurement and reporting requirements of fair value. The statistical tests of hypothetical factors are presented in Table 3.

Topic (4): what Characteristics reflected in the banking business affect the implementation of fair value in Iran's banking industry?

Table 5. The Fuzzy t-test and TOPSIS results on the factors restricting the implementation of a fair value basis in the banking industry

Question		Mean (S.D[1])	Test		TOPSIS Score
			P-value	Result	
Legal structure	Differences between the Iranian banking industry in terms of governing laws, regulations, and the business model with conventional international banking	8.04 (2.14)	1	Accept	0.63
	Riba-Free Banking rules and regulations Incompatibilities with IFRS	6.67 (2.83)	0.26	Accept	0.47
	Sharia rules defined in the riba-free banking law governing how the bank interacts with depositors and borrowers	6.40 (2.83)	0.14	Accept	0.44
	The prolonged judicial process of collecting banks' claims and collaterals	6.31 (2.88)	0.13	Accept	0.41
Policy setting structure	Mandatory obligations for banks to make loans	8.69 (1.33)	0.91	Accept	0.72
	Market opacity and lack of motivation to solve the issue	8.9 (1.17)	0.9	Accept	0.7
	Instability in policy-making and regulation of businesses	8.10 (1.60)	1	Accept	0.67
	Refusal to divulge concealed accumulated losses caused by the implementation of IFRS in the banking system	8.71 (1.71)	1	Accept	0.62
	The dominant role of government and other governing institutions in intervening with market	8.48 (1.56)	1	Accept	0.58
	banking sanctions	7.60 (2.55)	1	Accept	0.57
	The non-transparent and unconventional shareholding structure of banks	7.06 (2.47)	0.45	Accept	0.52
managerial structure of banks	Poor corporate governance	8.07 (1.87)	1	Accept	0.66
	Management instability in banks	8.06 (1.79)	1	Accept	0.61
	Lack of independent board of directors in the banking system	8.08 (1.77)	1	Accept	0.61
	Bank management avoids disclosing the actual amount of non-performing loans	7.79 (2)	1	Accept	0.54
	Existence of codified and approved policies in the banking business	5.11 (2.53)	0	Not accepted	-
Characteristics reflected in the banking business(j)[2]	The high volume of loans obtained by affiliates or political tycoons	8.95 (1.33)	0.96	Accept	0.73
	Lack of effective risk management system in banks (including processes, software systems, etc.)	8.46 (1.49)	1	Accept	0.72
	Lack of a reliable and comprehensive customer history database in the banking system	8.38 (1.48)	1	Accept	0.72
	The inefficiency of risk management and customer accreditation processes	8.67 (1.44)	1	Accept	0.70
	The multiplicity of banks subsidiaries with various fields of business	6.92 (2.28)	0.35	Accept	0.52
	The complexity of the Iranian bank's business model due to the unconventional activities of financial intermediation	7.53 (1.8)	0.73	Accept	0.44

1 Standard deviation
2- This section is part of joined questions

Table 5. Continued

Question		Mean (S.D)	Test		TOPSIS score
			P-value	Result	
Characteristics reflected in the banking business(d)[1]	According to the current credit policies of Iranian banks, the rate of loan contracts covers the time value of money.	3.32 (2.6)	0	Not accepted	-
	According to the current credit policies of Iranian banks, the rate of loan contracts (in addition to the time value of money) covers the customer's credit risk.	3.29 (2.74)	0	Not accepted	-
	According to the current credit policies of Iranian banks, credit risk is offset by increasing the quantity and quality of collateral instead of higher rates.	7.01 (2.62)	0.17	Accept	-
	In the current situation, banks' interest rates for loans are lower than the real market rates.	8.08 (1.96)	1	Accept	-
	If fair value is applied in Iranian banks, the net assets of the balance sheet will decrease.	6.32 (3.35)	0.09	Accept	-
	Having the authority to use fair value (in the cases provided for in the IFRS) to measure certain assets/liabilities will be a potential tool for managing earnings and concealing bank imbalances.	7.63 (2.42)	1	Accept	-

This question investigates Characteristics reflected in the banking business that make fair value implementation in Iran's banking industry inconvenient. The purpose of this question is to identify Iran's banking business characteristics that are not consistent with what is required in the standards about how and when to measure and report fair values across different items in the financial reporting of banks. The statistical tests of hypothetical factors are presented in Table 5.

5. Research Findings

Topic (1): Legal structure

All factors in this section have been accepted, with the most critical factors being; Differences in governing laws, regulations, and business models with conventional international banking, riba-Free Banking rules and regulations, Incompatibilities with IFRS, Sharia rules defined in the riba-free banking law governing how the bank interacts with depositors and borrowers.

Topic (2): Policy setting structure

All factors in this section also had been accepted, with the most critical factors being; Mandatory obligations for banks to make loans, Market opacity and lack of motivation to solve the issue, Instability in policy-making and regulation of businesses

Topic (3): Managerial structure

All factors in this section have been accepted, with its most important factors being; Poor corporate governance, Management instability in banks and lack of independent board of directors in the banking system

1- This section is consistent of discrete questions

Topic (4): Characteristics reflected in the banking business

Results show that legal, policy setting and managerial structure reflect banking business characteristics incompatible with IFRS requirements of reporting fair values. Characteristics such as a High volume of loans obtained by affiliates or political tycoons, Lack of effective risk management system in banks, Lack of reliable and comprehensive customer history database in the banking system, and Inefficiency of risk management and customer accreditation processes.

Not pricing the considerations for the time value of money or credit risk and lower cost of financing from the banking system compared to market realities are characteristics inflected to banking business which undermines the implementation of fair value in the banking system.

6. Conclusion

The backbone of fair valuation is how markets perceive economic events. In order for fair valuation to work properly, there are two basic conditions. First, the price should be clear, including all the features attached to the measured item. Secondly, the market as a provider of information must reflect true economic facts. We considered Features that undermine these two conditions as incompatibilities. Then we mapped these incompatibilities into three aspects; Legal structure, Policy setting structure, and Managerial structure. Our findings showed that the current legal structure of banking operations has shortcomings that reduce the quality and undermines the possibility of fair value implementation in the banking system. This is primarily due to differences like the law on the relationship between banks and customers and how to deal with interest and interest-bearing items. These change the business model compared to conventional banking, so it cannot be treated as such. Also, our legal structure allows for governmental intervention, especially in the money market, through Regulations of the Central Bank and the Monetary and Credit Council.

According to the evidence, we are moving towards a more state-owned economy on the side of policy settings. Price control policies in the real economy and the money market, restricting banks on how to take deposits and make loans with rates that do not reflect market facts risk, shows that we are moving away from the market logic in this regard. Finally, the same goes for the managerial structure level. The main goal here is to provide for governmental plans because of the governmental dominance in shareholding positions. These altogether indicate that the value relevance and reliability of fair value measurement in an environment with governmental dominance is extremely compromised. We should not push for a market base measure when our goal is a governmental-supportive economy instead of an efficient economy. Numbers coming out of a supportive economic market are an amalgam of economic realities and government-supportive plans and pressures which do not carry much information value and are also subject to manipulation.

In the end, it can be said that the current application of the law on riba-free banking in Iran does not comply with the requirements of measuring fair value, and in the current situation, the economic environment approach will not accept this market-based measure.

References

1. Aghili Kermani, P. (2002). Risk Management in Traditional Banking Compared to Interest-Free Banking. In *Proceedings of the 13th Islamic Banking Conference, Tehran: Higher Institute of Banking* (In Persian).
2. Alimoradi, M., Aliahmadi, S., and Foroghi, D. (2019). The Effect of Managers Discretion in Fair Value Measurement on Investment Selling Decisions. *Journal of Accounting Advances*, *11*(2), pp. 253-284. https://doi.org/10.22099/jaa.2019.32550.1831

3. Badia, M., Duro, M., Penalva, F., and Ryan, S. (2017). Conditionally conservative fair value measurements. *Journal of Accounting and Economics*, *63*(1), pp. 75-98. https://doi.org/10.1016/j.jacceco.2016.10.006
4. Barth, M. E., and Landsman, W. R. (1995). Fundamental issues related to using fair value accounting for financial reporting. *Accounting Horizons*, *9*(4), pp. 97. https://www.proquest.com/openview/7d3c88102eced284d3b22d35ab95de2f/1?pq-origsite=gscholar&cbl=3330
5. Basel Committee On Banking Supervision, 2015, Guidance On Credit Risk And Accounting For Expected Credit Losses
6. Fiechter, P., and Novotny-Farkas, Z. (2017). The impact of the institutional environment on the value relevance of fair values. *Review of Accounting Studies*, 22(1), pp. 392-429. https://doi.org/10.1007/s11142-016-9378-7
7. Golmohammadi, M., and Rahmani, A. (2018). Technical challenges of implementing fair values in financial reporting of Iran: emphasizing on IFRS13 requirements. *Journal of Accounting and Auditing Review*, 25(3), pp. 387-414 (In Persian).https://doi.org/10.22059/acctgrev.2018.259285.1007908
8. Shamkuts, V. (2010). Fair Value Accounting, University of Iceland, Faculty of Business, Unpublished Master's degree thesis. Reykjavik, Iceland. http://skemman.is/stream/get/1946/4234/12284/1/Thesis_fixed.pdf
9. Poon, W. W. (2004). Using fair value accounting for financial instruments. *American Business Review*, 22(1), pp. 39-41.
10. Thornton, G. (2011). IFRS News special edition. USA: Grant Thorton International Limited. United States
11. Beatty, A., Chamberlain, S., and Magliolo, J. (1996). An empirical analysis of the economic implications of fair value accounting for investment securities. *Journal of Accounting and Economics*, 22(1-3), pp. 43-77. https://doi.org/10.1016/S0165-4101(96)00429-6
12. Heaton, J. C., Lucas, D., and McDonald, R. L. (2010). Is mark-to-market accounting destabilizing? Analysis and implications for policy. *Journal of Monetary Economics*, 57(1), pp. 64-75. https://doi.org/10.1016/j.jmoneco.2009.11.005