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Research Paper

The Value Relevance of Fair Value of Marketable Securities Portfolio in the Investment Companies[1]

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INTRODUCTION

The category of investments is considered a significant aspect of a company's assets and is duly acknowledged by standard setters, leading to the establishment of specific accounting standards for its treatment. Ensuring the accurate application of these standards holds particular significance in the financial reporting of companies operating in the investment industry. In accordance with paragraph 29 of Iran's Accounting Standard No. 15, marketable investments held as current assets can be reflected in the balance sheet using either the market value or the lower of cost and net sales value as permissible methods. Additionally, irrespective of the classification and valuation criteria used within the financial statements, all marketable investments are required to be reported based on market value as supplementary disclosures. Therefore, investment companies and holding companies disclose the market value of their investment in tradable securities on stock exchanges in the explanatory notes of their annual and quarterly financial reports. Furthermore, as per paragraph 9 of article 7 of the third chapter of the executive directive on the disclosure of information for registered companies, since 2007, they are obligated to prepare and disclose information regarding their investment portfolios at the end of each month, within 10 days after the month's end.

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The fundamental question arises regarding the comparative utility of market value versus historical cost for marketable securities portfolios, particularly in light of evolving accounting standards favoring fair values. Despite the obligatory disclosure of market value for stock market investments as supplementary information, the feasibility of aligning this practice with contemporary standards advocating fair values poses a pertinent query. The necessity for conducting this research is underscored by the growing significance of investment companies in the Iranian stock market, aiming to foster a culture of indirect investment and providing investors with deeper insights into the relationship between accounting information and stock prices.

The innovation of this study lies in several aspects. Firstly, it contributes additional evidence on the association between fair value-based accounting figures and stock prices. Secondly, it marks the first investigation into the correlation between accounting information of marketable securities portfolios and stock price reactions of investment companies in the Iranian stock market. Thirdly, while existing theories predominantly focus on the correlation of earnings per share and book value per share with stock prices, this research explores the market value of marketable securities portfolios as a significant determinant affecting the stock price of investment companies, thereby expanding the scope of existing studies. Lastly, the study also offers additional insights into the impact of financial crises on the value relevance of the examined accounting figures, shedding light on Iranian investors' behavior and reactions.

MATERIALS AND METHODS

This study focuses on assessing the relative and incremental value relevance of competing measures, namely cost and market value, using multiple linear regression of accounting variables on stock prices. Additionally, the robust regression method was employed to ensure the reliability of the results. The study spans a monthly time period from March 21, 2018, to April 30, 2022, with the statistical population comprising all investment companies admitted to the Tehran Stock Exchange market before 2018. Ultimately, based on available data from 47 companies, the population was narrowed down to 2,350 company-month observations.

RESULTS AND DISCUSSION

According to Table No. 1 (right side), the market value variable of the investment portfolio and the cost of the non-stock market investment portfolio show a significant positive relationship with the current stock price at the 99% confidence level. Additionally, the book value variable of each share exhibits a significant positive relationship with the current stock price at the 95% confidence level. Therefore, based on these findings, there is no evidence to reject the first hypothesis.

Table 1. The results of the first and second hypothesis test

PRICE=$\alpha_0 + \beta_1 BV_{it} + \beta_2 \mathrm{STOCKCOST}_{it} + \beta_3 \mathrm{OTHERSTOCKCOST}_{it} + \varepsilon_{it}$				Model 2	PRICE=$\alpha_0 + \beta_1 BV_{it} + \beta_2 \mathrm{PV}_{it} + \beta_3 \mathrm{OTHERSTOCKCOST}_{it} + \varepsilon_{it}$			Model 1
p-v	T	Std	Coefficient	p-v	T	std	Coefficient	Variable
0/321	0/990	0/194	0/193	0/043	2/020	0/163	0/331	BV

PRICE=$\alpha_0 + \beta_1 BV_{it} + \beta_2 \text{STOCKCOST}_{it} + \beta_3 \text{OTHERSTOCKCOST}_{it} + \varepsilon_{it}$				Model 2	PRICE=$\alpha_0 + \beta_1 BV_{it} + \beta_2 \text{PV}_{it} + \beta_3 \text{OTHERSTOCKCOST}_{it} + \varepsilon_{it}$				Model 1
p-v	T	Std	Coefficient		p-v	T	std	Coefficient	Variable
-------	---------	-------	---------		0/000	13/83	0/041	0/565	PV
0/002	2/981	0/312	0/931		0/000	4/358	0/274	1/194	OTHER STOCK COST
0/000	6/870	0/361	2/484		--------	----------	--------	---------	STOCK COST
0/000	58/598	0/016	0/955		0/000	37/878	0/023	0/895	AR(1)
0/0008	3/366	2998/29	10092/90		0/0001	3/9670	998/206	3960/783	C
P-V= 0/000	F= 821/55	D-W= 1/782	R^2= 0/934		P-V= 0/000	F= 1105/97	D-W= 2/026	AdjR^2= 0/945	R^2= 0/950
Vuong :LR test: 2/415 P-VALUE: 0/015 NUMBER: 2303									

To test the second hypothesis, the R2 of models 1 and 2 in Table 3 were compared, and the statistical significance of their difference was assessed using Wong's test. The results of Wong's test indicate a significant increase in R2 of the first model compared to the second model. Therefore, the evidence obtained supports the second hypothesis.

Regarding the third hypothesis, the results in Table 2 show that the coefficient of the market value of the stock market investment portfolio, in the presence of its cost, has decreased slightly but still maintains statistical significance at the 99% confidence level. However, the cost coefficient of the stock market investment portfolio lacks statistical significance. Thus, the observed increase in information content for this accounting item is not evident, and the available evidence also supports the third hypothesis.

Table 2. The results of hypothesis 3 test

PRICE=$\alpha_0 + \beta_1 BV_{it} + \beta_2 \text{PV}_{it} + \beta_3 \text{STOCKCOST}_{it} + \beta_3 \text{OTHERSTOCKCOST}_{it} + \varepsilon_{it}$					
VIF	**P-V**	**T**	**std**	**Coefficient**	**Variable**
1/395	0/043	2/016	0/164	0/330	BV
1/304	0/698	0/387	0/337	0/130	STOCKCOST
1/232	0/000	4/265	0/278	1/187	OTHERSTOCKCOST
1/462	0/000	12/376	0/045	0/560	PV
	0/000	37/884	0/023	0/896	AR(1)
	0/000	3/887	990/569	3851/238	C
	Prob 0/000	F= 883/853	DW=2/024	Adj R^2=0/945	R^2= 0/955

CONCLUSION

The empirical evidence from this research indicates that the cost, when compared to the market value, demonstrates lower relative value relevance and does not exhibit increasing value relevance in its presence. Consequently, the net book value of equity, which is a key financial statement metric, may encounter potential challenges in its utility for economic decision-making and may experience a reduction in quality characteristics. Despite this, there is an opportunity to enhance the quality of financial reporting by changing reporting standards to require the disclosure of market values of marketable securities portfolios in financial statements, alongside cost disclosure in explanatory notes, without incurring additional information provision costs for companies.

Critics of fair value argue against its role in exacerbating financial crises, particularly during the recent financial crisis. However, this claim has been refuted based on a report prepared by the US Securities Exchange Commission for Congress. Additional tests conducted in this research show that investors appropriately reacted to the crisis by reducing the value relevance of market value-related metrics in the stock market portfolio. Furthermore, the findings do not indicate that fair values contributed to worsening the crisis.

Keywords: Investment Portfolio, Fair Value of Investment, Value Relevance, Investment Industry, Disclosure Versus Recognition.

JEL Classification: C52, G11, G14, G31.