# Luca Pacioli and the Fair Value

## The importance of differentiating between technique and politics

Por: **SAMantilla**
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*Does accounting, according to Luca Pacioli, only include measurements at historical cost and, consequently, are fair value measurements unrelated to it?*

Possibly many answer affirmatively that question. However, things are not like that because in the background what there is is a contemporary debate, not resolved, between technique and politics: two faces that are not of the same coin so many times they appear together.

Luca Pacioli also incorporated estimates and valuations according to the criteria of the merchant. With reference to the markets of its time.

This is clearly stated in its *Tratactus XI De Computis et Scripturis.*

For the purposes of the comments contained in this article, the reference document that I use is:

**Pacioli, Luca. *Tratactus XI De Computis et Scripturis. "Summa de Arithmetica, Geometría, Proportioni et Proportionalita".* Ediciones Uade: Buenos Aires, 1995.** [Translation to the Spanish, carried out by Elisabeth Montale, of the version in modern Italian that, of the work of Fra Luca Pacioli, realized Carlo Antinori].

The *Tratactus XI De Computis et Escripturis* consists of 36 chapters, the last of which is "Recapitulation, or summary of all the present treaty so that, without extraordinary work, the mentioned things can be remembered." It is organized in three sections: (A) Summary of the principles and ways of carrying the mercantile books; (B) Things that should be recorded in merchants' books; and (C) Things that should be recorded in merchants' books

For the purposes of the topic that concerns us here, section B contains three paragraphs, each of which speaks for itself **[1]**:

> *2. As for the jewels and the goods that are your property, because you have earned them, or they have left you by will, or donated,* ***estimate the value in currency that can be attributed to each thing*** *... But keep in mind that these items* ***should not be less than*** *ten ducats each, because small things of little value are not recorded in detail in the book.* [The highlights are not from the original]
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> *3. For all the real estate you own and own, such as houses, land, property, stores, you must debit them in the house account and* ***value them according to your currency estimate*** *and credit them in the Capital account. And therefore debit what you own,* ***determine its value****, as I said and credit yourself in the aforementioned account.* [The highlights are not from the original]
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> *8. If you have yielded merchandise in barter, for example: you have sold a thousand pounds of English wool in exchange for pepper, that is, two thousand pounds of pepper; I wonder how this operation should be recorded in the book. Do so:* ***estimate in currency*** *what is worth the pepper, according to your criteria, suppose* ***you value*** *12 ducats a hundred, so the two thousand pounds have a value of 240 ducats in currency, so you will credit the 240 Ducats corresponding to the value of the sale ...* [The highlights are not from the original]

These three mentioned paragraphs have in common that they refer to:

- Estimates and valuations made by the merchant. In current technical language, it can be said that they refer to **Level 3** of the fair value measurements.

- Jewelry and merchandise received in non-exchange transactions, that is, they do not correspond to normal purchases and sales of the merchant. It's about profits, inheritances and donations. To incorporate them into your accounting, the trader must make an **estimate**, that is to attribute a value to him. Interesting here that the things of little value are not acounted, although in the section C clarifies that they must be written down in the memory of the merchant.

- Real estate (houses, land, property, stores) and merchandise transferred in barter (exchange for another good) must be valued according to the **estimate** that the merchant makes in the currency.

Consequently, measurement at historical cost (or at amortized cost) is not the only measurement system to which Luca Pacioli refers. It limits it to commercial transactions, that is, purchases and sales of merchandise. And it complements it with estimates of the value according to the criterion of the merchant.

The confrontation historical cost vs. fair value has in its background a contemporary debate, not resolved, between technique and politics: two faces that are not of the same coin so many times they appear together. But, in any case, and this must be very clear, historical cost can not be identified with accounting and fair value can not be identified with policy. Although interested parties want to do so to create anxiety and not allow solutions to be reached.

This implies specifying certain understandings that, while playing in the same scenarios, have different perspectives and solutions. The following is a list of the main ones:

- Accounting is generally identified with the technique, while financial reporting  is associated with political solutions, in charge of regulators, given the absence of objectively convincing technical responses. That is why financial reporting is based on standards of 'general acceptance' and not through the application of laws and scientific processes.

- The accounting academy, as Chambers synthesized the theory that supports accounting principles, has 'lost' the battle against *practitioners*, as defined by Sprouse & Moonitz, who joined the cause of the issuance of standards as a political strategy that achieved its apogee with IASB (IFRS), FASB (USGAAP), IFAC (ISA) and AICPA (USGAAS) **[2]**. Recently, practitioners are increasingly facing a new political strategy that is making the issuance of standards independent, that is, no in charge of accountants / auditors).

- The technique is associated with the accuracy of the measurement, but it is claimed to the accounting technique that has not achieved precision in its measurements, given that there is no agreement on whether they should be at entry prices (historical cost) or exit prices (fair value). Its maximum achievement are the estimates. That is why it is recognized that the effective political solution is information that is useful for decision making, using a mixed system of measurement (historical cost and fair value).

- It is recognized that the technique provides reliability, while political decisions privilege relevance. But none dares to ignore either the reliability or the relevance.

The list can be continued and the discussions get longer and longer.

Some things are clear:

- The amortized cost accepts that the market is the criterion, as is the case of the lowest between the cost and the market. The impairment requirements of assets carried at amortized cost arise from the evaluation of when carrying value exceeds market value.

- Fair value accepts that there are situations in which markets can not be the reference (they are illiquid) and estimates must be used in the judgment of the entity (models).

- Advocates of historical cost generally refer to their successful application in situations of economic well-being, but they forget that in those same situations markets also worked well and fair value operated well.

- Critics of fair value generally refer to how it has behaved on depression and assume that in those same times the historical cost worked well, but this is an mistake: on depression the amortized cost also failed.

- The historical cost and the straight line method do not guarantee objectivity, they only allow easy (recurrent) accounting solutions that do not guarantee in any way that the results (balances) are objective. They do not necessarily work in non-recurrent measurements.

- The current dynamics of the markets, characterized by change, disruption, acceleration, etc., give more use to a variety of estimates. Because they are characteristic of the markets and the measurements should reflect this. The fair value is correct when showing dynamic estimates.

- Accounting as a discipline is weak because it does not have a strong academy to support it. Therefore, it has not been able to even agree on whether the measurement is at historical cost (focused on the income statement) or at fair value (focused on the statement of financial position).

- *Practitioners* impose their own conditions (including issuance of the standard and regulatory actions) because they privilege doing business over scientific objectivity. That is why the practical solution ('policy') is a mixed measurement system that does not offer measurement accuracy but allows the majority to be happy. Relevance on reliability.

- The judges have tried to decide, but have only solved specific cases submitted to litigation, not the general problem. For that reason, the legal definitions of fair value have not been successful, although they have helped to achieve some clarifications through the issuance of standards, according to the different contexts and historical situations.

The debate between theory and politics continues open. It will not disappear in the short and medium term.

What is clear is that Luca Pacioli, in addition to measuring at historical cost, also uses fair value measurements and more specifically, according to level 3 of the current fair value hierarchy, that is, estimates of the value according to the merchant's criteria.

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[**1**] These texts have been translated into English from the Spanish document referred to above

**[2]** An in-depth analysis of the controversy between Chambers (theory) and Sprouse & Moonitz (politics), is found in Chap. 10 “The history of the fair value term and its measurement”, on: Livne and Markarian. 2018. *The Routledge Companion to Fair Value in Accounting* (Routledge Companions in Business, Management and Accounting). Taylor and Francis. Edición de Kindle. 2018.
The main reference documents for this analysis are recognized as classics:

- Chambers, RJ 1961, Towards a general theory of accounting, Hyde Park Press, Adelaide, SA.
- Chambers, RJ 1965, “Measurement in accounting”. Journal of Accounting Research, vol. 3, no. 1, pp. 32–62.
- Sprouse, RT & Moonitz, M 1962, A tentative set of broad accounting principles for business enterprises (Accounting Research Study No. 3), American Institute of Certified Public Accountants, New York