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# ACCOUNTING CHOICE AND COMPARABILITY: EVIDENCE FROM FAIR VALUE OPTION USE IN U.S. BANKS

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The choice between historical cost (HC) and fair value (FV) measurement is highly debated among standard-setters, academics, and practitioners. Stakeholders disagree on whether accounting measurement choices improve or undermine comparability—the extent to which similar (different) economic events are reflected in similar (different) accounting numbers — enabling meaningful comparison across firms and time.

The fair value option (FVO) allows entities to apply FV to most financial assets and liabilities, that would otherwise be measured at HC. Critics argued this discretion could reduce comparability by allowing different treatments for identical assets or liabilities.

## Background and Policy Relevance

The way entities measure their assets and liabilities is not merely an accounting detail—it shapes how investors, regulators, and managers assess risk and performance. Historical cost is the default measurement for many financial instruments. Historical cost is given by fair value at inception, but subsequent changes in the

fair value are not recognized. This can create measurement mismatches when such instruments are managed alongside related items measured at fair value. Fair value reflects “current market conditions”, with valuations updated at each reporting date. While this enhances relevance, it can introduce volatility. Moreover, if fair values are estimated using unobservable inputs (level 3 inputs), it can also introduce subjectivity.

The FVO introduced by the U.S. Financial Accounting Standards Board (FASB) and mirrored by the International Accounting Standards Board (IASB), gives firms discretion to elect fair value for certain financial instruments. The intent was to reduce distortions in the “mixed-attribute” accounting model, where some assets and liabilities are measured at historical cost while related assets and/or liabilities are at fair value.

As an intuitive illustration of the impact of the “mixed-attribute” accounting model, consider an asset or liability normally measured at historical cost (e.g., a loan) that economically hedges another position measured at fair value (e.g., a interest rate swap or other derivative). Without the FVO, measuring these two economically related asset-liability differently creates artificial volatility in reported earnings, preventing the financial numbers from faithfully reflecting the underlying hedging. With the FVO, the bank can measure the hedged item also at fair value, eliminating the mismatch and allowing the accounts to reflect the true economic relationship – namely asset-liability management. As a result, investors and analysts can more easily compare performance across banks that engage in similar risk management strategies.

Yet, discretion sparked controversy. The American Accounting Association and dissenting FASB members warned that allowing different treatments for the same instrument would undermine comparability—a fundamental qualitative characteristic of financial reporting (AAA 2007; FASB 2007). Without comparability, investors and regulators cannot reliably evaluate or benchmark firms.

Given that banks are among the heaviest users of financial instruments, and central to financial stability debates, understanding how the FVO affects comparability has major policy implications.

## Insights from Research

In our recent research (Fontes, Panaretou and Shakespeare 2025), we analyse a sample of 673 U.S. bank holding companies between 2007 and 2019, covering the period after the FVO’s introduction. Out of the 673 US banks in our sample, 35% elected the FVO between 2007 and 2019. The findings from this study can be summarized in four key aspects. First, FVO enhances comparability when used as intended. Banks that adopt the FVO become more comparable with one another. This effect is strongest when elections address accounting mismatches. They also become more comparable with banks that never adopt the FVO, as the non-adoption likely reflects lack of accounting mismatches. Second, intent matters more than election. Comparability improves only when elections align with standard-setters’ objectives. Moreover, opportunistic or misaligned elections do not yield comparability gains. Third, banks generally use FVO responsibly. Evidence suggests that banks are not electing FVO primarily for earnings management. Instead, they use it to present their economic position more accurately. Finally, not all FVO elections are equal. Elections for liabilities appear particularly effective in enhancing comparability, consistent with research on asset-liability management. Conversely, elections involving Level 3 fair values (unobservable inputs) may reduce comparability because estimates differ across banks.

## Relation to Prior Research

The findings from Fontes et al. (2025) build on earlier work, first by showing that the FVO also has positive effects on comparability. Previous literature highlighted reduced earnings volatility and increased information asymmetry as the benefits of the FVO (Muller et al., 2011; Blankespoor et al., 2013; Fontes et al., 2018). Second, existing research on accounting choice between fair value and historical cost generally finds that firms outside the banking sector make limited use of fair value when given the option, particularly for illiquid non-financial assets (Christensen & Nikolaev, 2013; Cairns et al., 2011). This reflects a broader concern that fair value, while more relevant, can reduce reliability in certain settings. Extending this literature to banks, Fontes et al. (2025) show that the choice can improve—not weaken—comparability under specific conditions. Third, broader

research shows that changes in accounting standards influence comparability: studies of IFRS adoption find that comparability improves when standards are applied consistently and converge across firms and countries (DeFond et al., 2011; Barth et al., 2012; Yip & Young, 2012; Barth et al., 2018). Fontes et al. (2025) show that comparability can be strengthened not only through consistent standards, but also through carefully designed discretion such as the FVO.

## Conclusion

The debate between historical cost and fair value measurement has long divided practitioners, investors, and standard-setters. Fontes et al. (2025) provide evidence that discretion, when properly guided, can enhance rather than undermine comparability. The policy implication is that accounting flexibility matters: discretion combined with clear standards and transparent disclosures, can produce financial reporting that faithfully reflects economic reality and meets the objectives of accounting. For banks, the evidence highlights the value of flexibility in ensuring that asset-liability management and hedging strategies are accurately represented in financial statements. For academics, the study highlights comparability—often overlooked compared to earnings volatility or information asymmetry—and shows that measurement discretion can, under specific conditions, strengthen rather than weaken comparability.

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