The objective of accounting and the meaning of mark-to-market valuation

Now, let us consider about relationship between the concept of realized income and valuation gains or losses on financial assets. Before going on to the discussion of this issue, it would be helpful to compare the realized income and economic income and reconfirm the relationship between them. As already discussed in detail, with regard to financial assets in the proper sense of the word, the results of investments would be measured at the same amount under both of the two income concepts. In cases of financial assets that are mere investments of surplus money and can always be freely sold by the piece, their values are equal to the market prices no matter who holds them and a change in their market prices is in substance same as realization of cash flow. On the contrary, in cases of physical assets used in business, whereas changes in the market value and the value of goodwill affect the economic income, they will not affect the realized income until they are realized as cash flows. In this process, goodwill is generated as an expectation of future results of business investments and while it disappears as time passes all or part of it is transformed into the value of tangible assets. This process is irrelevant to realized income, although important to the economic income. Result of investment is realized when it has been released from the business risk, and measurement of realized income does not recognize all value changes of assets, but recognizes a portion that is realized as value of financial assets. Of course, when summing up the entire period of a real investment, there would be no difference between the economic income and the realized income. Unless we regard the goodwill generated by an investment as an element of the capital to be maintained, the amount of income is anyway determined ultimately by the total cash flows of the investment and its results. Therefore, the difference between these two concepts is no more than difference in the period to which income is attributed. Both concepts result in inter-period allocation of net cash flows 7). Then, which will better serve the objectives of accounting information, the allocation of cash flows based on the concept of economic income, or the allocation of cash flows in a systematic manner (independent of the changes in the value of assets) based on the concept of realization? It is a traditional view that financial statements should provide information that is useful for investors to assess the corporate value through their own forecasts of future results 8). When considered based on such usefulness to investors' expectation formation process, the major issue is the meaning each of income information has. Let us first consider about the result of a business investment. As mentioned many times, this forecast varies with the enterprise that makes the investment. Investors by themselves forecast the result and thereby assess the value of assets invested in the business. The value of physical assets, which determines the economic income, is a result of such assessment by the investors and it is not an ex ante information useful to investors' assessment. Although income measured only by changes in market price ignoring the value of goodwill is also a kind of economic income, such information is not useful for investors in forecasts of future cash flows or assessment of the goodwill inherent in the enterprise. As long as cash flows generated from business investments depend on intangible management resources inherent in each enterprise, to be useful to forecast future results, income information should capture the actual cash flow realized by the enterprise, after all. By comparing the result with the ex ante expectation, investors can revise their expectation and assessment of the value of the investment. Such a meaning, known as feedback value 9), has been attached to the realized income.On the other hand, in cases of financial assets, at least for those which can be sold freely by the pieces, there will be no difference in the valuation of assets, whichever concept of income is applied.Since there is no goodwill value in financial assets, their valuation is completed by identification of their market prices. For such assets, current market value would be the most useful information.However, it is not clear to what extent the income measured on the basis of the changes in market prices is useful to forecasts. The fact that financial assets have no goodwill value is rather consistent with the view that the future results of investments in such assets will have nothing to do with the past results and such income information is not useful to the formation of expectations 10). Considering in this way, whichever the income concept is chosen, information of income from financial investments might not have any more meaning to investors' expectation formation than the market value information of stock variables 11). However, at least, it would be information that is compatible with the forecasts of future cash flows, in that cash flows arising in the period are compared with the expectation at the beginning of the period. Except for the special case where changes in market prices do not mean the realization of cash flows, valuation gains or losses on financial assets may not be irrelevant information to the assessment of corporate value based on the forecasts of future results. In this respect, there is a basic difference from the cases of physical assets.