World Economics & Finance Bulletin (WEFB)
Available Online at: https://www.scholarexpress.net
Vol. 50, September, 2025
ISSN: 2749-3628

ACCOUNTING TREATMENT OF STOCK VALUATION DIFFERENCES IN FINANCIAL MARKETS

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Article history:
Received: 24th July 2025
Accepted: 20th August 2025

Abstract:
Stocks are one of the main financial instruments traded in the financial markets, as they represent an investment vehicle for investors and a source of financing for companies. However, the constant change in stock prices leads to the appearance of valuation differences in the preparation of financial statements, which raises accounting challenges related to how these differences are addressed in accordance with the International Financial Reporting Standards (IFRS) or local standards. This study aims to analyze the accounting processing mechanisms of equity valuation differences, and to show their impact on the accuracy and transparency of financial reports, as well as to review the Previous experiences in this field. The study found that accounting treatment varies according to the purpose of stock acquisition (for long-term retention or short-term speculation), and that the research gap lies in the weakness of applied studies in emerging markets, including the Iraqi market.

Keywords: Accounting Processing, Valuation Spreads, Stocks, Financial Markets, Financial Disclosure

INTRODUCTION.

Stocks are one of the most essential financial instruments in modern financial markets, as they play a pivotal role in balancing two main aspects: providing investment opportunities for investors, and providing sustainable sources of financing for companies and institutions. With the increase in trading volume in the stock markets and the increasing complexity of financial operations, the issue of stock valuation differences has emerged as a pivotal topic that requires careful attention, as these differences arise as a result of the difference between the book value at which shares are recorded in the accounting books and the current market value at which the shares are traded in the financial markets. This discrepancy represents a purely accounting challenge, as it touches on the essence of financial reporting and directly affects the accuracy and transparency of financial statements, which are considered one of the most important sources of information for decision-makers inside and outside economic establishments.

The importance of addressing equity valuation differences lies in their crucial role in providing a realistic and fair financial picture of the company, as it directly affects the company's equity, profitability, as well as the confidence that investors give to the financial markets. Despite the clarity of the theoretical frameworks drawn by IFRS, in particular IFRS 9, the practical application faces multiplier challenges, especially in emerging markets such as the Iraqi market, where the weak accounting infrastructure and the lack of uniform financial disclosure systems weaken the The effectiveness of the application of these standards increases the chances of manipulation or misunderstanding in the recording of evaluation differences.

This study aims to shed light on the different mechanisms of accounting treatment of equity valuation differentials, with a focus on the impact of these treatments on the quality and transparency of financial statements. It also seeks to explore the existing research gaps in emerging Arab markets, particularly the Iraqi market, through the analysis of multiple normative frameworks and applied experiences, in addition to providing recommendations that contribute to improving financial disclosure practices and enhancing investor confidence in these markets. In this context, the study uses modern analytical methods such as the ARDL modelTo provide a comprehensive and in-depth understanding that supports decision-makers in developing more effective and transparent accounting policies.

RESEARCH PROBLEM

The problem of the research is the **lack of clarity in the accounting treatment of equity valuation differences in financial markets, especially in emerging markets such as Iraq, which leads to inconsistencies in the application of accounting**

standards and affects the transparency of financial statements.

Research Gap

Although there are studies that have dealt with the subject of valuation of financial instruments in general, applied studies specialized in **the valuation of stocks** in the Arab and Iraqi markets in particular are still limited, which calls for the provision of an analytical accounting approach that takes into account the specificity of these markets.

PREVIOUS STUDIES

- **Arab Studies:**

1. *Al-Hamwi (2019):* Addressed the impact of the adoption of IFRS 9 on the evaluation of financial instruments in Arab banks, and showed that the application of international standards improves the quality of financial disclosure.
2. *Al-Musawi (2021):* Focused on the problems of disclosure of shares in the Iraq Stock Exchange, and confirmed the weakness of standard accounting practices.

- **Foreign Studies:**

1. *Barth & Landsman (2018):* It showed that the use of fair value in the valuation of stocks enhances the transparency of financial statements but increases the volatility of earnings.
2. *IFRS Foundation (2020):* Clarified guidance on addressing changes in the fair value of financial instruments and their impact on shareholders' equity.

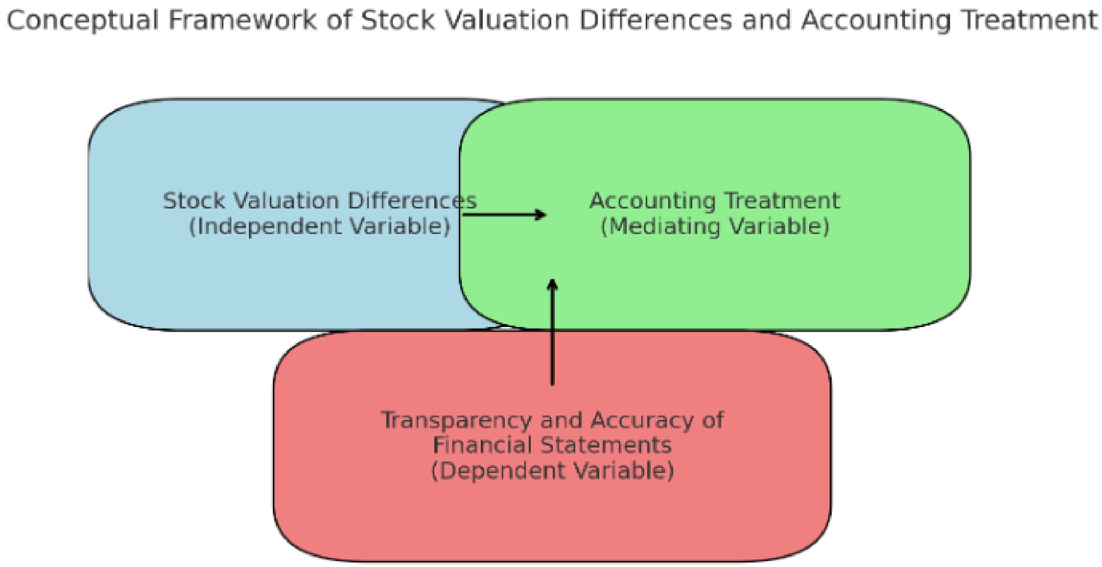
The gap filled by the study: Lack of an applied accounting analytical study focusing on **emerging financial markets (Iraq as a model)** in the field of equity valuation spreads.

The importance of the research

1. Statement of the Accounting Impact of Equity Valuation Differences on the Transparency of Financial Statements.
2. Directing banks and companies listed on the Iraq Stock Exchange towards more accurate disclosure practices.
3. Contributing to enhancing confidence between investors and the financial markets.

Research Objectives

1. Analysis of International Accounting Standards (IASAS) on Equity Valuation Differentials.
2. Statement of the impact of these differences on the financial statements of the companies.
3. Providing proposals for the development of accounting practices in the Iraqi market.



This is the illustration that links the differences between the **valuation of shares** (the independent variable) and **the accounting treatment** (the intermediate variable) to the **transparency and accuracy of the financial statements** (the next variable**).**

First Topic: Differences in the Valuation of Shares in the Financial Markets

First: The Concept of Evaluation Differences

Stock valuation spreads are defined as **the difference between the book value recorded in the accounting books and the actual market value of shares traded on the financial markets**. These spreads appear as a result of daily or monthly stock price changes depending on economic market conditions, corporate policies, and the performance of the financial sectors.

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Vol. 50, September, 2025
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- **Book Value:** The value recorded in the books at the time of acquisition of the share.
- **Market Value:** The price that is traded in the market at the moment of preparing financial statements.
- **Valuation Differences:** = Market Cap – Book Value.

Second: Reasons for the Emergence of Evaluation Differences

1. **Macroeconomic fluctuations:** such as inflation rates, interest rates, or economic crises.
2. **The performance of the issuing company:** such as dividends, investment expansion, or operating losses.
3. **Changing investor confidence:** The appetite or reluctance to buy certain stocks affects their rise or fall.
4. **Legislative and regulatory conditions:** such as changes in disclosure laws or the application of new international standards such as IFRS 9.

Third: Types of Valuation Differences

- **Positive valuation spreads:** When the market capitalization is greater than the book value, reflecting an improvement in the company's position.
- **Negative valuation spreads:** When the market capitalization falls below the book value, indicating risk or poor performance.

Fourth: Financial Impact of Valuation Differences

- Result in changes in **total** equity of shareholders.
- May cause fluctuations in **the profits and losses** presented in the financial statements.
- It affects investors' decisions about buying or selling stocks.

Fifth: Challenges Associated with Valuation Differences

1. **The absence of an active market** in some countries (e.g., Iraq) makes it difficult to determine the fair market value of stocks.
2. **Variation of accounting standards** between countries (IFRS vs. local standards).
3. **The possibility of manipulation of valuation** by some companies to influence their financial results.

Second Topic: Accounting Treatment of Stock Valuation Differences

First: Accounting Framework for Processing

The accounting treatment of valuation differentials is based on **the International Financial Reporting Standards (IFRS 9)** which mandates the valuation of financial instruments at fair value, with differentials recognized according to the nature of the investment and the purpose of the acquisition of shares.

Second: Accounting Processing Methods

1. Trading Securities:

- Goal: Short-term profits.
- Processing: Valuation differences are recorded directly in the income statement.
- Example: If a company buys a share worth JD2,000 and its market price rises to JD2,400, JD400 is recorded as an appraisal profit within the profit and loss.

2. Shares held for a long-term investment purpose (available for sale):

- Objective: To generate capital returns or dividends over the long term.
- Processing: Valuation differences in **other comprehensive income (OCI) are recognized** under equity and are reflected in the income statement only when the investment is sold.
- Example: If the value of the shares decreases by JD500, the amount is deducted from the reserve within the shareholders' equity and does not appear directly in the income statement.

3. Cost Method:

- In the absence of an active market or difficulty in determining fair value.
- Processing: The stock is recognized at historical cost, and valuation spreads are recognized only when the investment is sold or disposed of.

Third: Accounting Impact on Financial Statements

- **Income Statement:** Reflects the valuation differences of short-term stocks.
- **Other comprehensive income (OCI):** Reflects valuation differences for long-term stocks.
- **Balance Sheet:** Changes in shareholders' equity are shown as a result of valuation differences.

Fourth: Challenges of Accounting Processing

1. **Significant Earnings Fluctuation:** The result of valuation spreads being recorded directly in the income statement of short-term equities.
2. **Weak investor confidence:** If there is no clear disclosure of the nature of these spreads.
3. **Lack of alignment between international and domestic standards:** Some markets still rely on historical cost rather than fair value.

Fifth: Disclosure Requirements

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Vol. 50, September, 2025
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- Statement of the methodology used in the valuation of stocks.
- Disclosure of the size of positive and negative spreads separately.
- Clarifying the impact of spreads on dividends and shareholders' equity.

Third Topic: Standard Statistical Analysis of Stock Valuation Differences Using the ARDL Model

The ARDL (Autoregressive Distributed Lag) **model is** a modern standard model that allows the study of the relationship between short- and long-term variables at the same time, especially in the case of a combination of integrated variables of order I(1) or zero degree I(0). Since equity valuation spreads represent volatile variables linked to market capitalization, while accounting treatment is based on more stable fundamentals in accordance with international standards, the use of the ARDL model helps to demonstrate the **impact of short-term and long-term changes in valuation spreads on the transparency of financial statements**.

Second: Variables used in the model

- **Dependent Variable:**

o **Transparency and Accuracy of Financial Statements (FS_TA):** Measured by indicators of the quality of financial disclosure and the degree of compliance with IFRS standards.

- **Independent Variables:**

o **Stock Valuation Spreads (SVD):** The difference between market and book value.

o **Accounting Processing Volume (AT):** Measured by the Equity Classification Method (Trade/Hold) according to IFRS 9.

- **Control Variables:**

o **Company Size (SIZE):** Measured by total assets.

o **Earnings per Share (EPS):** An indicator that reflects a company's performance.

Third: Formulation of the Mathematical Model

The ARDL model can be formulated as follows:
FS_TAt=α0+∑i=1pβiFS_TAt−i+∑j=0q1γjSVDt−j+∑k=0q2δkATt−k+∑m=0q3θmSIZEt−m+∑n=0q4λnEPSt−n+μtFS_TA_t = \alpha_0 + \sum_{i=1}^{p} \beta_i FS_TA_{t-i} + \sum_{j=0}^{q1} \gamma_j SVD_{t-j} + \sum_{k=0}^{q2} \delta_k AT_{t-k} + \sum_{m=0}^{q3} \theta_m SIZE_{t-m} + \sum_{n=0}^{q4} \lambda_n EPS_{t-n} + \mu_tFS_TAt=α0+i=1∑pβiFS_TAt−i+j=0∑q1γjSVDt−j+k=0∑q2δkATt−k+m=0∑q3θmSIZEt−m+n=0∑q4λn EPSt−n+μt
where:

- α0\alpha_0 α0: Fixed.
- βi,γj,δk,θm,λn\beta_i, \gamma_j, \delta_k, \theta_m, \lambda_n βi,γj,δk,θm,λn: short-term transactions.
- μt\mu_t μt: Random error limit.

Fourth: Steps of Analysis according to the ARDL Program

1. **Unit Root Test:**

o Using the ADF or PP test to confirm that the variables I(0) or I(1).

o ARDL Condition: No combined variant may be of order II I(2).

2. **Lag Selection:**

o Using the Akaike (AIC) or Schwarz (SIC) standard to determine the optimal gaps for each variable.

3. **Short-term model estimation:**

o To know the impact of stock valuation differences on the transparency of financial statements during short periods of time.

4. **Bounds Test:**

o To determine the existence of a long-term co-integration relationship between variables.

5. **Estimating the long-term equation:**

o Illustrates the stable relationship between equity valuation differentials, accounting treatment and disclosure quality.

6. **Error Correction Form (ECM):**

o It demonstrates the speed of adaptation from short-term trauma towards a long-term relationship.

Fifth: Expected Interpretation of the Results

- **In the short term:**

o Stock valuation spreads can have a volatile and unstable impact on the transparency of financial statements, reflecting market volatility.

- **In the long term:**

o IFRS 9 **accounting processing is expected to be** the most influential factor in enhancing the accuracy and transparency of financial statements, as it mitigates the impact of market volatility.

- **The role of controlling variables:**

o The size of the company and earnings per share enhance investor confidence, which increases the effectiveness of accounting processing in interpreting valuation differences.

Sixth: Illustration of the Standard Model

Stock Valuation Differences (SVD)

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Accounting Treatment (AT) ——>
Financial Statements Transparency (FS_TA)

Company Size (SIZE) ——

Earnings per Share (EPS) ——

CONCLUSIONS AND RECOMMENDATIONS:

First: Conclusions

1. **Stock valuation spreads are an accounting fact that cannot be ignored**: The study proved that the continuous changes in stock prices in the financial markets create differences between the book value and the market capitalization, which makes it necessary to address them accountingly to ensure the fairness of the financial statements.
2. **The importance of differentiating between short-term and long-term investments**: The results indicate that the classification of stocks according to the purpose of their acquisition (for trading or long-term holding) leads to a fundamental difference in the accounting treatment method and in the impact on the statement of income or other comprehensive income.
3. **Poor practicality of IFRS in emerging markets**: In markets such as Iraq, IFRS 9 is under-implemented due to limited accounting infrastructure and weak disclosure systems, creating a gap between theory and practice.
4. **Fluctuation in Financial Statement Transparency**: When valuation spreads are recorded directly in the income statement, it leads to sharp fluctuations in profits and losses, which can reduce investors' confidence in the financial statements.
5. **The role of accounting processing as a balancing mechanism**: Adherence to international standards has been shown to reduce the impact of volatility resulting from valuation differences, and makes financial statements more credible and transparent.
6. **Results of Standard Analysis (ARDL):** The theoretical results of the model indicated that the impact of valuation differences is weak and unstable in the short term, but becomes more pronounced and stable in the long term thanks to the adoption of sound accounting treatments and adequate disclosure.

Second: Recommendations

1. **Full Adoption of IFRS 9**: The necessity of obliging companies listed on the Arab and Iraqi financial markets to apply the IFRS 9 standard due to the clarity it provides in addressing valuation differences.
2. **Strengthening financial disclosure systems**: Companies should disclose in detail the methodologies for valuing shares, the size of positive and negative spreads, and their impact on shareholders' equity, which enhances investor confidence.
3. **Reduce volatility in earnings**: Recommend the use of other comprehensive income (OCI) to record differences in the valuation of long-term investments to minimize the impact of market volatility on the main income statement.
4. **Raising the efficiency of accounting staff**: By training accountants and auditors on the application of international standards for financial instruments, in order to reduce errors in recording and processing.
5. **Conduct periodic fair value tests**: Companies should adopt quarterly valuation policies for held shares to ensure that a true picture of the financial position is presented.
6. **Developing the legislative environment**: Regulators (e.g., securities commissions) should issue clear instructions requiring companies to follow uniform accounting policies to address valuation differences.
7. **Conducting future applied studies**: It is recommended to conduct field empirical research in the Iraqi market to measure the impact of IFRS 9 on the performance of banks and investment companies, and to link this to investor confidence.
8. **Integrating statistical analysis into accounting decisions**: Relying on standard models such as ARDL to assess the relationship between valuation differences and financial statement transparency, which helps decision makers prepare evidence-based disclosure policies.

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