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FAIR VALUE ACCOUNTING AND STOCK VALUATION OF FIRMS LISTED INTHE MANUFACTURING SECTOR IN NIGERIA

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ABSTRACT

The goal of this study is to analyze how the historical cost approach of valuingassets in Nigerian manufacturing businesses is influenced by the fair value accountingmethodology. From a total of twelve listed petroleum businesses on the Nigerian StockExchange, five were selected at random. As a descriptive study, secondary data was collected.The Central Bank of Nigeria's Bureau of Statistics supplied data on performance reports and stock prices for the assets under examination, while historical values were collected from the published annual financial statements of the firms and fair values were assessed using the priceindex. When comparing assets appraised at fair value and those valued at historical cost, the T-test statistical technique was applied to discover if there is a significant difference. Profession accounting organizations should continue to study asset valuation in order to establish a consistent method for determining the value of an asset.

KEYWORDS: fair value accounting, stock valuation, historical cost accounting, profit reported, stock price

INTRODUCTION

A nation's economic growth depends heavily on its industrial sector. This is due to the fact thatit produces important items for human well-being, provides employment possibilities for bothexpert and unskilled workers, and is crucial in the pursuit for self-reliance. The government and monetary authorities have taken a variety of steps to help the industry, including mandated credit and concessionary interest rate regulations. However, the sector's long-term existence isdependent on its capacity to satisfy its growing financial obligations. Creating a profit is the primary motivation for forming a commercial enterprise, and this is assessed using specific metrics like return on assets, return on equity, and profits per share. Using accounting ratios, Nwanyanwu (2014) discovered that the best way to measure a company's financial success is by comparing the data in its financial statements with the profits it has generated in the past. Tests of profitability concentrate on comparing income to one or more major activities or characteristics that are assessed in financial statements (Van-home, 2002).

Profitability, according to Owolabi and Obida (2012), is the capacity of a company's commercial activity to generate a profit. It examines how an organization's scarce resources might be effectively managed to generate value to the company. Many accounting standards have been introduced throughout the years to improve the objectivity of commercial organizations' financial statements. Fair value accounting has replaced historical cost accounting in the last several decades. This system is being applied by numerous regulatory agencies, including the International Accounting Standards Board (IASB), the FinancialAccounting Standards Board (FASB), and others. Although historical cost accounting represents assets and liabilities at their original price, fair value accounting indicates the currentmarket worth of such item or obligation. A company's financial statements are impacted substantially by the accounting treatment of its various assets and liabilities, which in turn has a considerable effect on management choices. In assessing a company's creditworthiness, creditors and investors prefer to look at the value of its assets, while lenders see this as a sign of how well it is now operating and how it will continue to do so in the future (Zyla, 2010). According to Zyla (2010a). Although fair value accounting has an impact on the financial statement, it has no direct impact on the statement of cash flows unless there is a tax advantagegiven when using fair value accounting, according to Moran (2010). In spite of the existence of empirical literatures on fair value accounting, depreciation, and profitability in Nigeria (Jayairam, 2013; Enahoro & Jayeoba, 2013), the methodologies reached have been divergent.If you're asking about depreciation, you're more likely to get a negative answer than a positiveone. Accordingly, in light of these findings, this research intends to investigate the reported profit and stock price of enterprises in manufacturing adopting either a fair value accounting or historical cost accounting technique.

Objectives of the study

The study is aimed at comparing the impact of fair value accounting approach on tock valuation of firms listed in the manufacturing sector in Nigeria. Specifically, the study soughtto achieve the following:

1) Compare the profitability reports of listed firms in the manufacturing sector who adopted Fair value approach and those who does not.
2) Compare the stock price of listed firms in the manufacturing sector who adopted Fair value approach and those who does not.

Research Questions

The following research questions were formulated to guide the study:

1) Is there any significant difference between profitability reports of listed firms in the manufacturing sector who adopted Fair value approach and those who does not?
2) Is there any significant difference between stock price of listed firms in themanufacturing sector who adopted Fair value accounting approach and those who does not?

Hypotheses

HO1: There is no significant difference in the profitability reports of listed firms in themanufacturing sector who adopted Fair value approach and those who does not.
HO2: There is no significant difference in the stock price of listed firms in the manufacturingsector who adopted Fair value approach and those who does not.

Conceptual Review

Fair Value Accounting (FVA)

By comparing revenue to the current replacement cost of assets used in earning, this method of financial reporting calculates profits. This method's rationale is based on the idea that the business will continue to exist. In the income statement, it indicates the true cost of replacing assets that are no longer useful (Meigs, 2012). FVA's profit number typically equals the maximum amount that a corporation may provide its shareholders and yet maintain its currentsize and scope of activities, according to the researchers. It is claimed that Glautier and Underdown (2013), although maintaining the same viewpoint as Meigs (2012), noted that FVAis concerned with net asset value to the company and comprises cost of repairs, realizable value,and current value. After accounting for the effect of price changes on the finances necessary torun the existing company and keep its operational capability, they went on to state that FVA isa modification of historical cost profit to obtain the surplus. FVA is a deviation from the historical cost theory, according to Meigs (2012). According to him, the phrase "fair value" typically refers to the current equivalent cost of assets, and in the current cost financial report,expenses are represented at the projected cost to replace the same item sold or used up. Thus, fair value accounting focuses on projections of current market value rather than modificationsto prior expenses for changes in the overall price level. While agreeing with Meigs and Hendriken (2012), FVA is a way of accounting which determines prices that would have to bepaid for an asset or its uses if they were already held, supporting their point of view. As for inventory, fair value is determined by the current purchase price of each item. The best way todetermine fair value for plant, equipment, and other property is to utilize asset values of comparable conditions and of the same age. IASB's position on fair value was outlined in International Financial Reporting Standard 13-Fair value measurement, which was based on the following ideas. An active market is one in which transactions for the asset or obligation take place often and frequently enough to provide pricing information on a regular basis. Whenselling an asset or transferring an obligation, an exit amount is calculated. Market players' useof a non-financial asset to maximize the asset's worth or the group of assets and liabilities to which the asset is put to best use (iii). Most Advantageous Market: the market that optimizes the quantity that would be obtained for the sale of the asset or reduces the amount that would be paid to move the responsibility after taking into account transaction costs and shipping fees. Market with the largest volume and intensity of activity for a given asset or obligation (Deloitte,2013) (Deloitte,2013). There are various aspects that go into evaluating the fair valueof an asset, as well as the costs of replacement and the value that may be obtained by the item. There are many buyers and sellers, hence the price of an item in a competitive market may bepredicted to reflect the current value of that asset, if it is regarded to be that way by other firms. There is no market for old assets, hence FVA advises estimating the fair value of an equal newitem bought in the present established market minus cumulative depreciation over time, whichcorresponds to asset age (Hendriksen, 2012). (Hendriksen, 2012). The author, Hendriksen (2012). For this reason, FVA tends to depict cost and value in a more realistic amount, which is essential for making decisions during price changes.

Historical Cost Accounting (HCA)

The historical cost convention is a standard valuation process in which resources are valued according to their acquisition price (Glautier & Underdown, 2013). At the time of acquisition,assets are valued at their original cost. Using this as a benchmark for comparing previous coststo present costs is common practice. It's largely regarded by the Conservatism Convention thatthe revenue and expenditure predictions presented by accountants are overly pessimistic. Thereare no records of revenues until they are almost guaranteed, but there are records of costs as soon as they are a distant possibility. When it comes to determining the cost of assets, accountants often use the historical cost approach to come up with the lowest asset cost and thehighest liability cost. For many, the historical cost approach is preferred over the current cost strategy because it is focused with providing an accurate record of an entity's transactions ratherthan the current value of the organization at a particular moment (Godfrey ,2012). This methodmay provide some evidence to shareholders of management's stewardship in allocating financial resources and money capital under management, but the records do not provide any insight into the value of the company as a going concern, except to the extent that operating income is a predictive device. According to the authors (Budge and Hendriksen, 2013),

Fair Value and Valuation

Fair value assessments, despite multiple researches showing their reliability, may directly increase stock valuation uncertainty. Penman (2007) believes that fair value accountingprovides meaningful book value for valuation, but that reported profits are inadequate. So, theeffective income statement that is used to communicate information and monitor performanceis created using historical costs. Fair value accounting advocates Barth and Landsman (1995) claim that this system may potentially allow for the valuation of every line item on a company'sbalance sheet in an ideal world. Profits, on the other hand, are unnecessary. As a result, they can't be included in valuation models since their statistics aren't appropriate. Barth et al. presentevidence for the notion that income statements are not meaningful for valuation because of fairvalue accounting (1995). (1995). It is determined that profit based on fair value is more variablethan income based on prior cost, which is researched by concentrating on US banks between 1971 and 1990. Using the residual income model, Penman (2007) shows that if a business based on historical cost accounting utilizes the valuation model that employs earnings, the valuation model will give an estimated value that is equivalent to market pricing. The impact of fair value accounting on stock valuation models is anticipated to be significant. Using fair value in a financial report is seen as causing irregular profits, which in turn causes inaccurate valuations to occur. The balance sheet, on the other hand, provides more reliable data for the review process.

Theoretical Review

Agency Theory

Egbunike and Abiahu (2017) state that "Agency theory has been frequently applied in literature to investigate the information asymmetry between principals (shareholders) and agent (management)". Agency theory includes a contract in which the shareholders (the principle) engage the management (the agent) to oversee the activities of the company in an efficient and effective manner. Many issues emerge from this arrangement since executives may have more knowledge than shareholders have regarding the company's future success. In an information asymmetry context, Arnold and Lange (2004) asserted that two agency issues arise. Due to both adverse selection and moral hazard, it's difficult to tell whether the agent is doing the jobfor which he or she was hired, or if they've done it to the best of their ability. Agency dilemmais avoided when the goals and obligations of the self-serving agents align with the goals and responsibilities of the principals. When there is divergence, however, the principles pay the agency costs as the agents strive to optimize their personal value at the risk of the principals (Udeh, Abiahu & Tambou 2017).

Empirical Review

Fair value accounting technique was explored by Olanrewaju (2015), in order to illustrate its influence on the historical cost method of asset appraisal in public limited firms. – From a population of twelve listed petroleum businesses on the Nigerian Stock Exchange, only five were chosen for further investigation. Data was gathered using a secondary method of data collection in order to conduct descriptive study. The price index was used to establish the fair values of the investments of the firms under inspection, primarily on data from the Bureau of Statistics as reported by the Central Bank of Nigeria, as well as from the issued annual audited accounts. As part of an effort to determine whether the gap between fair value and historical cost is significant, a T-test statistical approach was used. According to research findings, thereis a significant discrepancy between the fair value and historical cost valuations of assets. Financial statements generated using different approaches provided diverse information to customers, according to findings. The price level was the most important factor in determiningasset worth. As a result of the facts presented, it is concluded that financial statements based on historical cost methodology undervalue assets. As a result, it is impossible to accurately assess the worth of a company like this. The financial report based on the past cost technique of asset valuation may deceive the consumers of accounting information. In order to develop astandardized method for valuing financial assets, it is recommended that professional accounting organizations investigate measurement issues. As a result, accounting organizations should start a public awareness campaign on fair value and the need to deviate from historicalcosts during inflationary periods. For deposit money banks listed on the Nigerian Stock Exchange, Abiahu and Udeh (2019) studied the influence of fair value reporting on financial performance and business value. An eight-year period from 2008 to 2015 was used in the research, which relied on data acquired from official annual reports of 13 banks listed on the NYSE (pre-IFRS and post-IFRS). The research was based on the theory of agency, and descriptive analysis and SPSS Version 23 software and regression analysis were used to describe and evaluate the data obtained. Fair value reporting does not have a significant influence on reported profitability, according to theresearch. It was still possible to influence the worth of a company by demonstrating its fair value. Overall, this research shows that comprehension of fair value is not sufficient to analyze financial performance and position. Users should also be aware of the investment's previous costs. Companies should thus employ a hybrid measuring method (one that includes both fair and historical values) in reporting their operations so that the true value they create is reflectedin their financial statements.

Okafor and Ogiedu (2015) found that improves company performance management and has a positive impact on other business operations.There is adequate accuracy in Fair Value metricsto analyze a company's financial condition and profitability, according to Ijeoma (2014).According to Akpaka (2015), post-IFRS financial information was found to have littlevalue relevance compared to pre-IFRS financial information. According to Sanyaola, Iyoha, and Ojeka (2017), the adoption of IFRS by Nigeria's publicly traded banks has a significant and positive impact on their earnings per share (EPS).Using fair value accounting, Ibidunnia and Okere (2015) found a relationship between fair value reporting and trustworthiness in financial reporting. Fair value accounting has a direct correlation with the reliability of accounting information for Nigerian companies, according to a survey of 161 users of accounting information, including corporate investment analysts and corporate portfolio managers, and the Pearson product moment correlation technique and the Statistical Package for Social Science (SPSS) were used to test and analyze the data gathered. Nigerian manufacturing businesses' financial performance was analyzed by Chukwu and Akpeekon (2019). (2019). Fair value accounting's influence on the financial performance of Nigerian manufacturing businesses was explored in-depth utilizing a descriptive and quasi- experimental technique. Annual reports of ten (10) identified manufacturers listed on the Nigerian Stock Exchange from 2008-2010 (representing historical costs) and 2014-2016 (showing fair value regimes) were utilized to gather the data (representing fair value regimes)(representing fair value regimes). Four ideas were provided in the research. Using the least squares technique of multiple regression, the assumptions were checked. Fair value accountingappears to have a considerable influence on both profit before tax and asset return. In light of this, it is advised that fair value accounting be employed to give a more accurate appraisal of financial performance than the historical cost basis.

METHODOLOGY

This study used a descriptive research approach. The Nigerian Stock Exchange (NSE) in 2020was analyzed for ten industrial firms. The yearly reports for the years 2010 through 2020 wereused to collect secondary data for this research. The Nigerian Stock Exchange's website was used to get the company's market capitalisation. Descriptive statistics were used to analyze thecollected data. Statistical Package for the Social Sciences (SPSS) Version 26 was used to conduct the relevant tests. The p values given by the analyses were used to accept or reject thehypotheses. Null hypotheses are accepted if the probability is higher than 0.05; otherwise, p values less than 0.05 are accepted.

Analysis and Result

Table 1: Descriptive statistics on reported profit

	ACCOUNTING APPROACH	N	Mean	Std. Deviation	Std. Error Mean
PROFIT REPORTED	FVA	5	116372618.4000	249239852.28	111463450.4813 6

	HCA	5	3440376.800	967583.4114	432716.4563

SOURCE: SPSS OUTPUT (2021)

Table 1 above shows the mean difference in the profit of the firms listed in the manufacturing sector via fair value accounting and historical cost accounting approach. The result revealed that for the years considered, FVA has a mean value of 116372618.4000, while HCA has a value of 3440376.800. this implies that the profit recorded for FVA is better than that of HCA.

Table 2: Descriptive statistics on reported stock price

Group Statistics

	ACCOUNTING APPROACH	N	Mean	Std. Deviation	Std. Error Mean
STOCK PRICE	FVA	5	5450960.6000	4381005.99191	1959245.44155
	HCA	5	5678537.6000	5173282.64569	2313562.33252

SOURCE: SPSS OUTPUT (2021)

Table 2 above shows the mean difference in the stock price of the firms listed in themanufacturing sector via fair value accounting and historical cost accounting approach. The result revealed that for the years considered, FVA has a mean value of 5450960.6000, while HCA has a value of 5678537.6000. This implies that the stock price recorded for FVA is betterthan that of HCA.

Table 3: t-test analysis for hypothesis 1

		Levene's Test for Equality of Variances		t-test for Equality of Means	
		F	Sig.	T	df
PROFIT REPORTED	Equal variances assumed	7.052	.029	1.013	8
	Equal variances not assumed			1.013	4.000

SOURCE: SPSS OUTPUT (2021)

Table 3 above shows the t-test analysis for hypothesis 1. It revealed that the p-value of 0.029 at a df of 4 was obtained. Since, the p-value is less than the 0.05(0.029<0.05), the null hypothesis is rejected and the alternate hypothesis is upheld. Hence, there is a significant difference in the profitability reports of listed firms in the manufacturing sector who adopted Fair value approach and those who does not.

Table 4: t-test analysis for hypothesis 2

		Levene's Test for Equality of Variances		t-test for Equality of Means		
		F	Sig.	t	df	Sig. (2-tailed)
STOCK PRICE	Equal variances assumed	.987	.019	-.141	8	.891
	Equal variances not assumed			-.141	7.789	.891

SOURCE; SPSS OUTPUT (2021)

Table 4 above shows the t-test analysis for hypothesis 2. It revealed that the p-value obtained was 0.019 at a df of 8. Since, the p-value is less than the 0.05(0.019<0.05), the null hypothesisis rejected and the alternate hypothesis is upheld. Hence, there is a significant difference in thestock price of listed firms in the manufacturing sector who adopted Fair value approach and those who does not.

DISCUSSION OF FINDINGS

The result from research question 1 revealed that for the years considered, FVA has a mean value of 116372618.4000, while HCA has a value of 3440376.800. This implies that the profitrecorded for FVA is better than that of HCA. Also, the results from hypothesis 1 revealed thatthere is a significant difference in the profitability reports of listed firms in the manufacturing sector who adopted Fair value approach and those who does not. This is consistent with the findings of Chukwu, et al. (2019), Abiahu and Udeh (2019) who independently reported an increased and significant profit margin. The result in research question 2 revealed that for the years considered, FVA has a mean valueof 5450960.6000, while HCA has a value of 5678537.6000. This implies that the stock price recorded for FVA is better than that of HCA. Also, the result from hypothesis 2 revealed that there is a significant difference in the stock price of listed firms in the manufacturing sector who adopted Fair value approach and those who does not. The value of enterprises was shown to fall with fair value accounting considerably (p=0.05). This is in accordance with the resultsof Lin, Lin, Fornaro and Huang (2017).

CONCLUSION

The study has established that the profitability and stock prices reported when fair value accounting approach was used adopted is better than that reported when historical approach was adopted. The study also, affirmed that the there is a significant difference in the profitability and stock price reports of listed firms in the manufacturing sector who adopted Fair value approach. This may be linked to the adoption of IFRS by various countries of the globe. These worldwide standards designed to unify accounting processes and increase the usability of accounting information supported that item in financial statements are representedtruthfully.

RECOMMENDATION

During inflationary periods, Nigeria's accounting authorities should provide seminars for accountants and company managers to educate them on the importance of current costaccounting and the need to vary from historical cost accounting. The financial report of a company should be prepared using both historical and current cost methods at the same time. A company's genuine financial status would be known prior to announcing dividends and bonuses.

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