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The contribution of fair value accounting on corporate financial reporting in Nigeria

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Abstract

This study examined the contribution of fair value accounting on corporate financial reporting in Nigeria. The objective of the study is to ascertain the level and contribution of fair value accounting on providing useful information for investor's in Nigeria, to find out if Nigeria capital market structure pose a challenge to implementation of fair value accounting, and to determine if full fair value of financial instruments fulfils the aim of performance reporting. The method of data collection used in this study was field survey method involving the use of questionnaire administered to 562 samples. The method of data analysis was the Kruskal-Wallis rank sum test statistic. From the result of the analysis, it was found that the implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting. Also, it was observed that the Nigeria capital market structure would pose a challenge to implementation of fair value accounting. It was equally found that the full fair value of financial instruments fulfils the aim of performance reporting. The determination of the overall growth of most economy depends on how efficient and effective the stock market is, and in the Nigeria case there are still lots of challenges that have hindered the Nigerian Capital market from attaining international status and these could pose a challenge to implementation of fair value accounting in Nigerian financial system.

Keyword

Capital, Survey, Information, Financial Instrument, Economy, Stock Market

1. Introduction

Fair values reflect the most current and complete expectation and estimation of the value of assets or obligations, including the amounts, timing, and riskiness of the future cash flows attributable to assets or obligations. As such expectations lie at the heart of all transactions, which add to the belief that market efficiency would be enhanced if the information upon which such decisions are made is reported in the financial statements at fair value. Measurement of accounting elements is one of the crucial factors in the process of preparing financial statements, which fairly present economic activity of an accounting entity. Elements of financial statements can be measured by various attributes, corresponding to the nature of an element and the purpose for which the element has been incurred by entity. The reliability and relevance of the attribute measured are the key points of measuring assets, liabilities, equity and other elements [1]. According to [2], they noted that the problems that exist in today's financial markets can be traced to many different factors. One key factor that is recognized as having exacerbated these problems is fair value accounting. They explained further that fair value accounting is appropriate for assets that are held for trading purposes or if an entity's business model is based and managed on fair value. However, for traditional commercial banks and for loans, leases, and securities that are held to maturity, the argument goes, fair-value accounting can be inappropriate and misleading, especially in a time of crisis and when markets are illiquid. According to [3], the fundamental economic function of accounting standards is to provide agreement about how important commercial transactions are to be implemented. Ensuring disclosure quality of financial information is also mandatory for reducing information asymmetry and solving agency problems in the corporate sector.

In consideration of reliability and relevance of fair value, [4] found fair values relevant in the explanation of share prices. They gave substantial evidence that recognized and disclosed fair value measures to be relevant to investors and reliable enough to be reflected in share prices. Fair value measures which have consistency in definition, incorporate all elements of financial instrument measurement, invoke some degree of market discipline and which are more relevant to investment decision-making are better measurements for recognition of financial instruments within the basic financial statements. [5], still on relevance and reliability of fair value accounting explained that the general tenor of the fair value criticisms is that fair value information, particularly in the context of the Financial Crisis, lacks sufficient quality to be informative to investors and other financial statement users. There is a substantial body of accounting research that addresses this criticism using a variety approaches, particularly value relevance. Value relevance is a particularly applicable approach to address the relevance and reliability of accounting information because an accounting amount is value relevant only if it is relevant to investors' equity valuation decisions and sufficiently reliable to be reflected in share prices.

Considering the reliability of fair value measures, [6], considered the informational asymmetry created by such estimates and the ability of management to "manipulate the model inputs". He observed that if fair value accounting for financial instruments or non-financial assets is generally applied for financial statement recognition, accounting standard-setters and securities regulators face the challenge of determining how much latitude to give managers when they estimate fair values, balancing the benefit of permitting managers to reveal private information, thereby mitigating the adverse selection problem, and the moral hazard cost of their exercising discretion to manipulate earnings and balance sheet ratios that affect contracting relationships with lenders and, in the case of financial institutions, financial statement-based regulatory capital used by bank regulators interested in stability of the banking system. He noted that although the securities market tends to act as a disciplinary force to keep firms and its managers honest, it does so with a lag. They suggested that balancing the adverse selection and moral hazard problems is to require extensive disclosure of the underlying assumptions used when estimating fair values. In addition, [4], found that while disclosures did not reduce the information asymmetry and credibility issues, good corporate governance did increase reliability. They found evidence consistent with the information asymmetry problem continuing to exist, but the strength of corporate governance appears to ameliorate this problem. These results highlight the importance of corporate governance for the value relevance of accounting information, especially for information that is potentially less reliable. In their own contribution, [7], explained that countries with weaker investor's protection mechanisms are more likely to adopt International Financial Accounting Standards (IFRS) and therefore concluded that IFRS represent a vehicle through which countries can import investor protection and make their capital markets more accessible to foreign investors.

[8], explained that with the current controversy surrounding fair value accounting, it is important to understand actually what it is. According to him, under Generally Accepted Accounting Principles (GAAP), fair value is defined as the amount at which an asset can be bought or sold in a current transaction between willing parties, or transferred to an equivalent party, other than in a liquidation sale. On the opposite side of the balance sheet, the fair value of a liability is the amount at which the liability can be incurred or settled in a current transaction between willing parties, other than in liquidation. He added that fair value is sometimes referred to as "exit values". When fair value is not available due to lack of an actual transaction, it is logical to use information from an active market. An active market is a market in which securities as a whole are trading at a high volume. He stated further that, sometimes, quoted prices might not represent the best estimate of fair values. [9], simply stated in their study that fair value accounting represents the revaluation of unsold assets and liabilities to market prices on regular basis. According to them, it is primarily applied to financial assets and liabilities but however, three major groups of non-financial assets which include property, plant, investment property and intangible assets are also subject to fair value measurement. They noted further that active markets may not always exist in order to identify a market price for the specific asset or liability and that instead there should be established hierarchy that prioritizes the relative reliability of the inputs that may be used in establishing fair value. The fair value hierarchy consists of three levels and gives the highest priority to the most reliable inputs-quoted prices in active markets for identical assets or liabilities (Level 1), whereas the lowest majority is assigned to unobservable inputs (level 3), which are received as the least transparent and objective. Speaking on the challenges facing the application of fair value accounting in most developing countries, [10], outlined some of the major concerns associated with the application of fair value accounting in developing countries as inactive market, cost, skills shortage, government controlled markets, related parties, weak regulatory environment, and lack of valuation standard and guidance. [11], examined the perceptions of fair value accounting by auditors in Nigeria. They found that statements prepared under fair value accounting basis is more useful than those prepared under historical cost basis. Auditors, awareness of fair value issues in Nigeria is low, fair value accounting poses greater challenges for auditors than the historical cost basis, and they claim that fair value accounting is not appropriate within the Nigeria

context. [12], reported that many see fundamental inconsistency between measuring financial instruments at fair value and nonfinancial items largely on historic cost basis. Standard-setters recognize that whenever a boundary is drawn between financial statement items with different measurement attributes some inconsistencies and complexities often results. It is argued that there is economic logic in drawing a line between financial instruments and nonfinancial items, and more so than drawing a line including some financial instruments but not others. Conceptually, the periodic returns on financial instruments can be separated into three components with distinct sustainability or certainty [13]. [14], in his study raised the following issues to be challenges of implementation of fair value accounting in Nigeria: are corporate bonds and government bonds traded in active markets; are there expertise in development of valuation models; complex valuations required for measuring fair value of Foreign Exchange Contracts (FECs), Cross Currency Interest Rate swaps and other derivatives may be hard to find; will regulators allow fair value measurements for financial instruments of entities performing fiduciary duties. He concluded by suggesting that accounting standards and regulators should provide additional guidance targeting on how to determine when markets becomes inactive and determining whether a transaction or group of transactions is forced or distressed. Speaking against fair value, [15], argued that fair value accounting has been the principal cause of an unprecedented decline in asset values; an unprecedented rise in instability among financial institutions; and the worst economic crisis in the United States since the Great Depression. [16], noted the difference between fair value interest and amortized cost interest is sustainable because unexpected changes in interest rates and the resulting unexpected changes in fair values affect fair value interest calculations throughout the remaining lives of financial instruments. For example, an unexpected gain on a financial asset due to a decrease in interest rates in the current period reduces expected fair value interest revenue on the asset throughout its remaining life. This third component of the periodic returns to financial instruments is the unexpected change in their fair values during the period. Unexpected changes in the fair values of financial instruments are both unsustainable and uncertain. [17], said that it has been argued that different conceptions of what is for an accounting estimate to be reliable underlie the fair value debate as it has taken shape in the last decade. The language of subjectivity and objectivity is unhelpful in characterizing what is at stake; it is more useful to focus on the question of how certain valuation technologies do or don't become institutionally accepted as producing facts. However, the shift in accounting principles will not come without some additional effort by all capital market participants, including preparers, auditors, regulators, and users of this information. It is realized that accounting and reporting based on fair value principles, in comparison with historical cost-based principles, require more extensive and detailed analysis of the methods and assumptions used to determine values recognized in the financial statements. This in turn, will require market participants to redesign the current financial reporting model and to educate themselves in the application of these new principles. Moreover, [18], believes that fair value accounting is highly pro-cycling and should be abandoned or at least significantly modified in order to ensure that financial statements report information on stability of the entity rather than on its earnings power. [19], in their contribution reported that much of the controversy about Fair Value Assets results from confusion about what are new and different views about the purpose of Fair Value Assets. In their view they argued that the debate on Fair Value Assets dates back to several old accounting issues, like the trade-off between relevance and reliability, which has been debated for decades. They noted that it is important to recognize that accounting rules interact with other elements of institutional framework, which could give rise to unintended consequences. They stressed that manager's concerns on litigation could make a deviation from market prices less likely even when it would be appropriate. It is important to recognize that giving management more flexibility to deal with potential problems of Fair Value Assets (e.g. in times of crisis) also opens the door for manipulation. Managers' could use deviation from allegedly depressed market values to avoid losses impairments. Judging from evidence in other areas in accounting (e.g. a loan and goodwill) as well as U.S. savings and loans (S & L) crisis, this concern they stressed should not be underestimated. Hence, standard setters and enforcement agencies face a delicate trade-off (e.g. between contagion effects and timely impairment).

The objective of the present study is to ascertain the level and contribution of fair value accountings on providing useful information for investor's in Nigeria, to find out if Nigeria capital market structure pose a challenge to implementation of fair value accounting, and to determine if full fair value of financial instruments fulfils the aim of performance reporting.

2. Research Methodology

2.1. Description of the Study Population and Data Collection

The method of data collection used in this study was field survey method involving the use of questionnaire. A sample of 562 persons drawn from a population consisting of members of Nigerian Accounting Standard Board, members of Institute of Chartered Accountants of Nigeria/Association of National Accountant of Nigeria, Accounting lecturers and postgraduate accounting students, financial institutions, Government agencies and Nigeria Capital market.

2.2. The Kruskal–Wallis Analysis Rank Sum Test

Biological data from experience never follow a Gaussian (normal) distribution precisely, because a Gaussian distribution extends infinitely in both directions, so it includes both infinitely low negative numbers and infinitely high positive numbers. Many kinds of biological data, however, do follow a bell-shaped distribution that is approximately Gaussian. Because ANOVA works well even if the distribution is only approximately Gaussian (especially with large samples), these tests are used routinely in many fields of science [20].

An alternative approach does not assume that data of interest follow a Gaussian distribution. In this approach, values are ranked from low to high and the analyses are based on the distribution of ranks. These tests, called nonparametric tests, are appealing because they make fewer assumptions about the distribution of the data. But there is a drawback. Nonparametric tests are less powerful than the parametric tests that assume Gaussian distributions. If the samples are large the difference in power is minor. With small samples, nonparametric tests have little power to detect differences.

The Kruskal – Wallis test which is an extension of the Wilcoxon test for location with two independent samples from continuous populations ([20], [21], [22]).

2.3. Procedure for Calculating the Kruskal–Wallis Test

Rank all the scores in the experiment, irrespective of condition.

Add up the ranks for each condition to produce a rank total for each condition: $R_1, \cdots, R_k$ where k is the number of conditions.

Calculate H using the formula: $H = \frac{12}{N(N+1)} \sum_{i=1}^{k} \frac{R_i^2}{n_i} - 3(N+1)$ which allows for different numbers of subjects in each condition. N is the total number of subjects and $n_1, \cdots, n_k$ are the number of subjects in the k conditions.

The calculated value of H must equal or exceed the table value of χ^2 with $k - 1$ degrees of freedom at the chosen level of significance to reject the null hypothesis.

Decision Rule: The decision rule is reject the null hypothesis when the P-value is less or equal to the α=0.05, otherwise, accept the null hypothesis. Alternatively, when the Ch-square calculated is greater than the Chi-square tabulated the null hypothesis is rejected.

2.4. Data Presentation

Table 1. *Responses on whether fair Value Accounting provides more useful Information to Investors*

Question	SA	A	U	D	SD
1	182	244	65	44	27
2	161	216	78	101	8
3	173	278	70	30	11
4	122	213	133	82	12
5	161	254	70	42	35
6	232	188	70	27	25
7	214	254	68	16	10

Source: Field Survey (2013) See Appendix

Table 2. *Responses on whether Nigeria capital market structure pose a challenge to implementation of fair value accounting*

Question	SA	A	U	D	SD
8	108	184	112	104	54
9	137	176	76	134	39
10	72	74	144	189	83
11	131	244	99	55	33
12	108	224	121	74	35

Source: Field Survey (2013) See Appendix

Table 3. *Responses on whether full fair value of financial instruments fulfils the aim of performance reporting*

Question	SA	A	U	D	SD
13	228	169	98	47	20
14	153	271	75	49	14
15	161	216	104	53	28
16	207	222	103	25	5
17	207	222	103	2	6
18	244	233	55	28	2
19	197	180	76	76	33
20	167	258	97	32	8
21	162	224	56	41	59
22	201	207	52	30	19
23	183	263	63	34	19

Source: Field Survey (2013) See Appendix

3. Data Analysis

3.1. Kruskal-Wallis Test on Whether Fair Value Accounting Provides More Useful Information to Investors

H01: Implementation of fair Value Accounting does not provides more useful Information to Investors than historical cost reporting

H11: Implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting

Table 4: Ranks

	Option	N	Mean Rank
Response	1.00	7	25.57
	2.00	7	31.29
	3.00	7	16.43
	4.00	7	11.93
	5.00	7	4.79
	Total	35	

Key: 1= strongly agree, 2= Agree, 3= Undecided, 4= Disagree, and 5= strongly disagree

Table 5: Test Statistics[a,b]

	Response
Chi-Square	29.882
df	4
Asymp. Sig.	.000
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

3.2 Kruskal-Wallis Test on Whether Nigeria Capital Market Structure Pose a Challenge to Implementation of Fair Value Accounting

H02: The Nigeria capital market structure would not pose a challenge to implementation of fair value accounting

H12: The Nigeria capital market structure would pose a challenge to implementation of fair value accounting

Table 6: Ranks

	Option	N	Mean Rank
Response	1.00	5	13.80
	2.00	5	19.90
	3.00	5	14.20
	4.00	5	13.10
	5.00	5	4.00
	Total	25	

Key: 1= strongly agree, 2= Agree, 3= Undecided, 4= Disagree, and 5= strongly disagree

Table 7: Test Statistics[a,b]

	Response
Chi-Square	12.074
df	4
Asymp. Sig.	.017
a. Kruskal Wallis Test	
b. Grouping Variable: Option	

3.3. Kruskal-Wallis Test on Whether Full Fair Value of Financial Instruments Fulfils the Aim of Performance Reporting

H03: Full fair value of financial instruments does not fulfil the aim of performance reporting

H13: Full fair value of financial instruments fulfils the aim of performance reporting

Table 8: Ranks

	Option	N	Mean Rank
Response	1.00	11	41.36
	2.00	11	47.64
	3.00	11	27.14
	4.00	11	15.32
	5.00	11	8.55
	Total	55	

Key: 1= strongly agree, 2= Agree, 3= Undecided, 4= Disagree, and 5= strongly disagree

Table 9: Test Statistics[a,b]

	Response
Chi-Square	47.341
df	4
Asymp. Sig.	.000

a. Kruskal Wallis Test
b. Grouping Variable: Option

4. Discussion

The result of the analysis obtained in section 3.1 showed in Table 4 that majority of the respondents agreed that implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting since the highest mean rank (mean rank=31.29) was obtained for option 2 (Agree). Also, from Table 5 it was observed that implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting since the Chi-Square test statistic value obtained was 29.882 and a p-value of 0.00 which falls on the rejection region of the hypothesis. Hence, the null hypothesis (H01) was rejected since the p-value= $0.00 < \alpha = 0.05$, assuming a 95% confidence interval. This result implies that implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting.

The result of the analysis obtained in section 3.2 showed in Table 6 that majority of the respondents agreed that the Nigeria capital market structure would pose a challenge to implementation of fair value accounting since the highest mean rank (mean rank=19.90) was obtained for option 2 (Agree). Also, from Table 7 it was observed that the Nigeria capital market structure would pose a challenge to implementation of fair value accounting since the Chi-Square test statistic value obtained was 12.074 and a p-value of 0.017 which falls on the rejection region of the hypothesis. Hence, the null hypothesis (H02) was rejected since the p-value= $0.00 < \alpha = 0.05$, assuming a 95% confidence interval. This result implies that the Nigeria capital market structure would pose a challenge to implementation of fair value accounting.

The result of the analysis obtained in section 3.3 showed in Table 8 that majority of the respondents agreed that full fair value of financial instruments fulfils the aim of performance reporting since the highest mean rank (mean rank=47.64) was obtained for option 2 (Agree). Also, from Table 9 it was observed that the full fair value of financial instruments fulfils the aim of performance reporting since the Chi-Square test statistic value obtained was 47.341 and a p-value of 0.017 which falls on the rejection region of the hypothesis. Hence, the null hypothesis (H03) was rejected since the p-value= $0.00 < \alpha = 0.05$, assuming a 95% confidence interval. This result implies that the full fair value of financial instruments fulfils the aim of performance reporting.

5. Conclusion

This study examined the contribution of fair value accounting on corporate financial reporting in Nigeria. The objective of the study is to ascertain the level and contribution of fair value accountings on providing useful information for investor's in Nigeria, to find out if Nigeria capital market structure pose a challenge to implementation of fair value accounting, and to determine if full fair value of financial instruments fulfils the aim of performance reporting. From the result of the analysis it was found that the implementation of fair Value Accounting provides more useful Information to Investors than historical cost reporting this result is in line with findings by [3]. Also, it was observed that the Nigeria capital market structure would pose a challenge to implementation of fair value accounting. It was equally found that the full fair value of financial instruments fulfils the aim of performance reporting. The determination of the overall growth of most economy depends on how efficient and effective the stock market is, and in the Nigeria case there are still lots of challenges that have hindered the Nigerian Capital market from attaining international status and these could pose a challenge to implementation of fair value accounting in Nigeria financial system as found by the present study. We recommend that enabling environment should be strength by enlarging institutional capacity and attracting market participant. Also, we advocate that appropriate structures and governance processes for market should be established to create a wholesale investments market and annual institutional investors that will provide market depth and liquid.

Appendix

Sample of Questionnaire

Section A

S/No.	Question	SA	A	U	D	SD
1	Fair value of financial instrument faithfully represents the business activities than mixed measurement value or historical cost					
2	Full fair value of financial instrument provides sufficient information to influence decision making than mixed measurement value					
3	Fair value of all financial instruments reduces complexity and enhances the understanding of financial reporting					
4	Measurement of all financial instrument in external primary financial statements is more relevant if prepared on fair value bases than if prepared under mixed measurement model					
5	Full fair value accounting for financial instrument fulfils the objective of financial reporting and user's needs					
6	Fair value accounting provides more useful information to investors than historical cost reporting					
7	The use of valuation models for financial instruments for which no active market readily exist is not reliable					

Section B

S/No.	Question	SA	A	U	D	SD
8	The Nigeria capital market practices would pose challenge to implementation of fair value accounting					
9	Fair value accounting assumes deep and efficient market. Application of fair value accounting in Nigeria will be difficult					
10	The application will be impossible					

S/No.	Question	SA	A	U	D	SD
11	The level of activity market information awareness has made the market more efficient					
12	The level of sophistication on the Nigerian stock exchange recently can sail fair value accounting					

Section C

S/No.	Question	SA	A	U	D	SD
13	Fair value accounting could increase credit crunch					
14	Fair value is a representative of the resources that will be available for the entity to pay its debt if it is been assessed for credit facilities					
15	Fair value accounting is grounded in economic reality					
16	Fair value accounting facilitates informed investment decision capable of strengthening capital market					
17	Fair value accounting improves transparency and contribute to investor understanding about risk					
18	Fair value accounting allows companies to report amounts that are updated on regular and ongoing bases					
19	Fair value accounting limits company's ability to manipulate their net income because gains and losses on assets and liabilities are reported in the period they occur, not when they are realized as a result of transaction					
20	Fair value of financial instruments fulfils the aim the aim of performance reporting					
21	Full fair value of all financial instrument increase transparency					
22	Full fair value of financial instrument enhance comparability					
23	Financial statement being presented on a full fair value bases provide a better communication framework for preparers to provide users with financial information					

Key: SA= strongly agree, A= Agree, U= Undecided, D= Disagree, and SD= strongly disagree

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