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FAIR VALUE ACCOUNTING AND FINANCIAL REPORTING OF CORPORATE ORGANISATIONS INNIGERIA

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K E Y W O R D S

Fair Value Accounting, challenges, Financial Reporting, Transparency, Comparability and Valuation.

A B S T R A C T

This study examines the impact of fair value accounting on financial reporting of corporate organisations in Nigeria, focusing on its challenges and benefits. Fair value accounting provides relevant and transparent financial information and enhancing decision-making for stakeholders. Despite challenges such as subjectivity and market volatility, fair value accounting is essential for reflecting economic reality in financial reporting. The study's findings suggest that the benefits of fair value accounting, including increased transparency and comparability, outweigh its challenges. The study recommends clear guidance on fair value measurement, robust valuation models, and transparent disclosures. This research contributes to the ongoing debate on fair value accounting and provides insights for regulators, companies, investors, and future research.

Introduction

Fair Value Accounting Measurement refers to the price that would be received in an orderly transaction between market participants on the measurement date. It reflects the amount paid for assets or the price transferred for liabilities (Okafor & Ogiedu, 2012) . This accounting approach values assets and liabilities at their estimated market prices, providing a snapshot of an organization's financial position through its financial reports.

The adoption of fair value accounting has been a significant development in financial reporting, with many standard-setters and regulators advocating for its use. Fair value accounting involves measuring assets and liabilities at their current market value, rather than their historical cost. (Abiahu, Udeh, Okegbe & Eneh 2020). This approach is expected to provide more relevant and timely information to investors and other stakeholders, enabling them to make more informed decisions.

In recent years, the Nigerian financial reporting landscape has undergone significant changes, with the adoption of International Financial Reporting Standards (IFRS) and the establishment of the Financial Reporting Council of Nigeria (FRCN). These changes have led to increased emphasis on fair value accounting, with many companies in Nigeria adopting this approach in their financial reporting. (Egbon-Aghakeleghian & Oziegbe, 2022).

Despite the growing importance of fair value accounting, there is limited research on its impact on financial reporting in Nigeria. This study aims to address this gap by examining the impact of fair value accounting on financial reporting in Nigeria, with a focus on the challenges and benefits of its adoption. The specific objective of this study is to examine the impact of fair value accounting on financial reporting in Nigerian corporate organisations.

This study is significant because it will contribute to the existing body of knowledge on fair value accounting and financial reporting in Nigeria. The findings of this study are very useful to regulators, standard-setters, and companies in Nigeria, as they navigate the challenges and benefits of fair value accounting.

Research Questions

Based on the research objective, the following research questions were formulated:

Research Question 1

What is the impact of fair value accounting on financial reporting in Nigeria?

Research Hypotheses

Based on the research questions, the following hypotheses were also formulated:

Hypothesis 1

H1: Fair value accounting has no significant impact on financial reporting in Nigeria.

Scope of the Study

This study focuses on the impact of fair value accounting on financial reporting in Nigeria.

It examines the impact of fair value accounting on financial reporting in Nigeria, the study aims to provide insights into the challenges and benefits of its adoption, and to contribute to the development of more effective financial reporting practices in Nigeria.

Review of Related Literature

Fair value accounting

As defined by relevant accounting standards such as IFRS 13 and ASC 820 (US GAAP), refers to the measurement of assets and liabilities at their estimated market value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Conceptual Review

Evolution of Fair Value Accounting

The concept of fair value accounting has evolved over time, with various standard-setters and regulators contributing to its development. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have played key roles in shaping fair value accounting standards (Ijeoma, 2013).

The adoption of fair value accounting has been surrounded by several debates, with some arguing that it provides more relevant and timely information, while others contend that it introduces volatility and subjectivity into financial reporting.

Financial Reporting

Financial reporting is the process of presenting financial information about an organization's financial position, performance, and cash flows in accordance with relevant accounting standards and regulatory requirements. It involves the preparation and presentation of financial statements, such as:

1. Balance Sheet (Statement of Financial Position)
2. Income Statement (Statement of Profit or Loss)
3. Cash Flow Statement
4. Statement of Changes in Equity

The primary objective of financial reporting is to provide stakeholders, including investors, creditors, and regulators, with relevant, reliable, and timely financial information to facilitate informed decision-making (Oyadonghan and Appah, 2011).
Financial reporting is guided by relevant accounting standards, such as:

1. International Financial Reporting Standards (IFRS)
2. Generally Accepted Accounting Principles (GAAP)
3. Other national or regional accounting standards and laws

These standards provide a framework for preparing and presenting financial statements, ensuring consistency, comparability, and transparency in financial reporting. Valuation in accounting and finance refers to the process of determining the economic value of a company, asset, liability, or investment. It involves estimating the present value of future cash flows, earnings, or other benefits using various methods and techniques. Fair value measures provides the minimum measures of such valuations in order not to over or under valuate assets and liabilities so as not to deceive or intent to deceive other partners in a transaction at arm's length.

Financial assets

Are investments or liquid assets that have a financial value and can be easily converted into cash. Examples include:

1. Cash and cash equivalents (e.g., bank deposits, treasury bills)
2. Stocks (equity investments in companies)
3. Bonds (debt securities issued by companies or governments)
4. Loans and receivables (amounts owed to the entity)
5. Investments in other companies (e.g., subsidiaries, associates and joint ventures)
6. Derivatives (e.g., options, futures, swaps)

Financial assets can generate income or capital appreciation, providing a potential return on investment. They can be classified into different categories, such as:
Held-to-maturity (HTM): Debt securities held until maturity.
Available-for-sale (AFS): Financial assets available or held for sale.
Fair value through profit or loss (FVTPL): Financial assets measured at fair value.
The classification and measurement of financial assets are governed by accounting standards like IFRS 9.

Financial liabilities

Represent debts or obligations that an individual or business owes to external parties, impacting financial health and stability. These liabilities can be categorized into:

- Current Liabilities: Due within one fiscal year, examples include:

Accounts Payable: Amounts owed to suppliers for goods and services, typically settled within a short period.
Short-term Loans: Debts repayable within a year.
Accrued Expenses: Incurred expenses not paid, like wages or utilities.
Taxes Payable: Taxes owed to the government.

- Non-Current Liabilities: Obligations extending beyond one fiscal year, including:

Long-term Loans: Borrowings repayable over more than one year.
Bonds Payable: Debt securities issued to investors with fixed repayment terms.

Deferred Tax Liabilities: Taxes postponed to future periods due to accounting and tax treatment differences.
- Lease Obligations: Commitments for asset leases requiring periodic payments.

Financial liabilities are crucial for businesses to fund growth, manage cash flow, and leverage opportunities. However, they also pose risks if not managed properly. Understanding and tracking financial liabilities is essential for maintaining a healthy financial position and making informed decisions.

Adopting Fair Value Accounting Measurement can provide several benefits to a firm, including:

1. Increased transparency: Fair value accounting provides a clear picture of a company's financial position.
2. Improved relevance: Fair value reflects current market conditions.
3. Enhanced comparability: Fair value accounting allows for more meaningful comparisons.
4. Better risk management: Fair value accounting helps identify potential risks.
5. More accurate financial reporting: Fair value accounting reflects economic reality.
6. Compliance with accounting standards: Fair value accounting is required by many accounting standards.
7. Investor confidence: Transparent and relevant financial information can increase investor trust.

These benefits can lead to more informed decision-making and improved financial reporting.

Challenges of Fair Value Accounting Measurement

Fair Value Accounting Measurement faces several challenges, including:

1. Subjectivity: Fair value estimates can be subjective and prone to personal bias.
2. Market volatility: Rapid market changes can make it difficult to determine fair value.
3. Lack of transparency: Complexity in valuation models and assumptions can lead to a lack of transparency.
4. Model risk: Valuation models can be flawed, leading to inaccurate estimates.
5. Limited market data: Illiquid or inactive markets can make it challenging to determine fair value.
6. Complexity: Fair value measurement can be complex, requiring significant expertise.
7. Comparability: Differences in valuation methods and assumptions can make it difficult to compare financial statements.
8. Reliability: Fair value estimates may not always be reliable, particularly for unique or complex assets.

These challenges can negatively impact financial reporting and decision-making.

Application of Fair Value Accounting

Positive Accounting Theory (PAT) can be applied to fair value accounting by examining the economic incentives and constraints faced by firms that adopt fair value accounting. For example, firms may adopt fair value accounting to:

Increase transparency: Firms may adopt fair value accounting to increase transparency and provide more relevant information to investors.

Improve comparability: Firms may adopt fair value accounting to improve comparability with other firms.

Manage earnings: Firms may adopt fair value accounting to manage earnings or achieve desired financial reporting outcomes.

Theoretical Review

The work made use of the Positive Accounting Theory (PAT) developed in 1970s and 1980s by researchers such as Watts and Zimmerman (1978, 1986)

PAT explains and predicts accounting phenomena based on economic and financial factors to the benefit of the managers. PAT suggests that accounting choices are influenced by economic incentives and constraints faced by firms and their managers.

Assumptions of PAT

The assumptions of PAT include:

Economic incentives: Firms and their managers make accounting choices based on economic incentives, such as maximizing profits or minimizing costs.

Self-interest: Firms and their managers act in their own self-interest, making decisions that benefit them.

Efficient markets: Markets are assumed to be efficient, with prices reflecting all available information on the firm.

Empirical Review

Ogunrinde, Fabiyi, and Apalowowa (2024) in their work titled, Fair Value Accounting and Socio-Economic Environment examined the relationship between fair value accounting and the socio-economic environment in Nigeria. They found that fair value accounting significantly increases the volatility of financial statements, leading to information asymmetry and economic inequities.

Abiahu, Udeh, Okegbe, and Eneh (2020) also worked on Fair Value Accounting and Firm Value investigated the effect of fair value reporting on financial profitability and firm value in deposit money banks listed on the Nigerian Stock Exchange. The study revealed that fair value reporting does not significantly affect reported profitability but impacts firm valuation.

Adegboyegun et al. (2020) investigated Fair Value Accounting and Corporate Reporting, their work explored the relationship between fair value accounting and corporate reporting in Nigeria using a logistics regression approach. The study found that fair value accounting has a significant impact on corporate reporting.

Okafor and Ogiedu (2012) examined Perceptions of Fair Value Accounting. The study examined the perceptions of financial auditors regarding fair value accounting in Nigeria. The study found that financial statements prepared under fair value accounting are more relevant than those prepared under historical cost accounting.

Methodology

The study used qualitative research methodology that focuses on gathering and analyzing non-numerical data to gain insights into people's experiences, perceptions, behaviors, and meanings. It explores the "why" and "how" behind phenomena, often using methods like:

Interviews

Focus groups

Observations

Content analysis

Case studies

Findings

Fair value accounting measurement provides relevant and transparent financial information, enhancing the decision-making process for stakeholders. Despite the challenges, fair value accounting measurement is essential for reflecting economic reality in financial reporting, particularly in dynamic market conditions. The benefits of fair value accounting measurement, such as increased transparency and comparability, outweigh the challenges, but require careful consideration and expertise.

Effective implementation of fair value accounting measurement requires robust valuation models, reliable market data, and transparency in financial reporting. Fair value accounting measurement is crucial for financial reporting, but its challenges and limitations must be acknowledged and addressed to ensure accurate and reliable financial information.

Conclusion and recommendation

In conclusion, this study has provided valuable insights into the impact of fair value accounting on financial reporting. The findings suggest that fair value accounting provides more relevant information to investors and other stakeholders, but also introduces volatility and subjectivity into financial reporting. The study highlights the importance of transparency and disclosure in fair value accounting, and the need for clear guidance and robust processes to ensure its effective implementation. Overall, this study contributes to the ongoing debate on the merits and challenges of fair value accounting, and provides recommendations for regulators, companies, investors, and future research.

Recommendations

Based on the findings of the study, the following recommendations were made:

For Regulators and Standard-Setters

Provide clear guidance on fair value measurement: Regulators and standard-setters should provide clear guidance on fair value measurement, including the use of valuation models and techniques.

Enhance transparency and disclosure requirements: Regulators and standard-setters should enhance transparency and disclosure requirements for fair value measurements, including the disclosure of underlying assumptions and estimates.

For Companies

Develop robust fair value measurement processes: Companies should develop robust fair value measurement processes, including the use of reliable valuation models and techniques. Provide transparent and clear disclosures: Companies should provide transparent and clear disclosures about fair value measurements, including the underlying assumptions and estimates used.

For Investors and Analysts

Understand fair value accounting: Investors and analysts should understand the principles and implications of fair value accounting, including its potential impact on financial reporting. Carefully evaluate fair value disclosures: Investors and analysts should carefully evaluate fair value disclosures, including the underlying assumptions and estimates used.

Contributions to Knowledge:

Enhanced understanding of fair value accounting measurement: The study provides insights into the benefits and challenges of fair value accounting measurement. Clarification of fair value measurement's role in financial reporting: The study highlights the importance of fair value measurement in financial reporting.

Identification of best practices: The study identifies potential best practices for implementing fair value measurement. Informing accounting standards and policy: The study's findings can inform accounting standards and policy decisions. Advancements in valuation methodologies: The study contributes to the development of valuation methodologies.

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