

FAIR VALUE ACCOUNTING PRACTICES AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA**Nnah, Lazbery Ph.D****Department of Accounting, Ignatius Ajuru University of Education,
Rumuolumeni Port Harcourt, Nigeria***Email: nnahlazbery@gmail.com***ABSTRACT**

This study determined the relationship between fair value accounting and financial performance of manufacturing firms in Nigeria. The study employed an ex-post facto research design was adopted which involve quantitative methods of data presentation, data analysis and hypothesis testing. The population of study consists of all the listed manufacturing firms in Nigeria but the study selected four companies in Nigeria. The study adopted interval scale of measurement and preceding year basis of sampling, with a sample size of 28 year. Six (6) years each from the four selected manufacturing firms in Nigeria from 2015 to 2021. The source of data was secondary, obtained from Nigerian Exchange Group (NGX) formally known as Nigerian Stock Exchange (NSE). The study adopted multiple linear regression analysis to analyze the data with the help of Statistical Package for Social Science (SPSS) to determine the relationship between the variables to answer the research questions and test the null hypotheses at 0.05 level of significant. The study findings shown that, total assets fair value (TAFV) and fair value changes during the year (FVCDY) of fair value accounting had no significant relationship on return on equity (ROE) of financial performance of manufacturing firms in Nigeria. Therefore, the study recommended that firms should exercise caution in the application of fair value accounting most especially in term of forecasting return on capital employed and return on equity in order to avert the cyclical effect of it.

Keyword: Fair Value accounting practices, total assets fair value, financial performance and return on equity

INTRODUCTION

Fair value accounting measurement has become applicable in Nigeria in the determination of firm value and profitability of firms in Nigeria following the adoption of the International Financial Reporting Standard (IFRS) by the Federal Executive Council (FEC) to include financial reports of entities to present and provide useful information to potential investors, creditors and other users in making rational investment, credit and similar decisions (Chidoziem et al, 2020). This report represents management performance for the accounting period. Accounting principles and conventions are the instruments used in the preparation of financial statements to convey this information to various users. Olanrewaju (2015) the basic purpose of financial reporting is to provide information about an economic entity to the users in an economy such as Nigeria. Ahmad and Aladwan (2015) users of accounting information can be classified into two namely: the internal and external users. The internal users which include the management who uses it as a guide for decision making to aid better performance, the stewardship of management is measured based on their performance as rendered in the financial statements. The external users: these are the investors, creditors, shareholders, employees and government. All are interested in the operation of any business organization. This study therefore is an attempt to provide evidence on the impact of FVA on financial performance of deposit money banks in Nigeria. FVA brought about changes in definition, measurement, recognition of income etc and how it affects the accounting figure of earnings and book value of the firm.

The concept of fair value estimation has been a controversial issue in accounting. Fair value accounting is the method of accounting that estimates certain liabilities and asset of an entity at its

current market value, which seeks to report the current value of future cash flows related to an entity's assets or liabilities. Fair value accounting is the price that would be received to dispose an asset or transfer a liability in an orderly transaction between market participants at the measurement dates. In fair value accounting, entities report losses when the fair values of their assets decrease or liabilities increase. The losses reduce entities' reported equity and probably also reduce entities' reported net income. Toluwa and Power (2019) stated that, the primary activity in the overall process of financial reporting is the value measurement. Selecting a suitable evaluation base, such as the fair value at entry, historical cost, and fair value at exit (net realizable value), is open to the managerial discretion of the entity. Financial reporting under the fair value based accounting system states assets and liabilities at their respective current values. International Accounting Standard Board (2012); Financial Accounting Standard Board (2009); and International Financial Reporting Standard 13, defined fair value as the price that would be received to sell an asset or paid to transfer a liability in an armlet transaction between market buyers and sellers at the measurement date. Therefore, there is a great need to investigate if the use of fair value accounting has impact in the organizational performance. Akwu et al (2017) opined that earnings and book value per share are measures that different individuals, investors and financial analysts use to evaluate the performance of the private firms which is highly regulated sector in Nigeria.

Statement of the Problem

The major change that accompanied the international financial reporting standard (IFRS) is the use of fair value measurement as against historical cost measurement; scholars have argued that it is more realistic as it gives a fair view of firm book value unlike historical cost. Historical Cost Accounting (HCA) has failed to reflect the effect of changing price level, assets are disclosed in the statement of financial position at unrealistic values, the statement of profit or loss does not bear proper charges particularly for depreciation and cost of material consumed. Furthermore, the financial statements produced through Historical Cost Accounting lack global comparability and consistency. With particular concern to the banking industry, Fair Value Accounting has influenced definition, recognition and measurement of assets and liabilities, this change has direct effect on the earning and book value of the firm. This development gives rise to a need to examine if Fair Value Accounting has improved financial performance of manufacturing firms in Nigeria.

Aims and Objectives of the Study

This study determined the relationship between fair value accounting (FVA) and financial performance of Nigerian manufacturing firms. To accomplish this, two specific objectives are developed as stated below:

1. Determine the relationship between total assets fair value and return on equity (ROE) of manufacturing firms in Nigeria.
2. Determine the relationship between fair value changes during the year and return on equity (ROE) of manufacturing firms in Nigeria.

Research Hypotheses

In order to know the relationship between the fair value accounting and financial performance of manufacturing firms in Nigeria, the following hypotheses are formulated in the null form.

- Ho₁: There is no significant relationship between total assets fair value and return on equity (ROE) of manufacturing firms in Nigeria.
- Ho₂: There is no significant relationship between fair value changes during the year and return on equity (ROE) of manufacturing firms in Nigeria.

Conceptual Review

Fair Value Accounting Concept

Fair value accounting was defined in financial report principles exclusively issued by Financial Accounting Standards Board as the money received by selling capital or paid by transferring debts

in orderly transactions among market participants on a measurement date. It is an approach to financial reporting whereby profits are measured by comparing revenue with the current replacement cost of the assets consumed in the earning process. The logic of this approach lies in the concept of the going concern. It recognizes in the income statement, the cost which a going concern actually has to pay to replace its expiring assets (Lewis, 2012). They went on to say that the profit figure resulting from FVA closely parallels the maximum amount which a business can distribute to its owners and still be able to maintain the present size and scale of its operations. International Financial Reporting Standards (IFRS) are body of prescriptive rules and guidelines with global reach and appeal which provide direction and guidance on how business enterprises in a globalized world could achieve the goal of proper record keeping, transparency, uniformity, comparability and enhancing public confidence in financial reporting (Vanstraelen, 2005). Thus, failure on the part of the firm to apply the requirements of IFRS would result in inconsistencies, lack of accountability and transparency, distortion in financial reports, which in turn results into poor financial reporting practices and performance, and dissemination of accounting information that is of less value to any particular group of users (Osisioma et al, 2017).

The use of fair value measurement by IFRS reflects the most current and complete expectation and estimation of the value of assets or liabilities. 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 activities of an accounting entity. Fair value accounting measurements are relevant and reliable to decision making by managers for increased performance which attracts investors and reflection in the organizational share price (Gospel & Akpeekon, 2019). The international financial reporting standard (IFRS) 13 defines fair value as the amount 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 (that is, an exit price). This definition emphasizes fair value as a market-based measurement. When measuring fair value, an entity uses the assumptions that market asset or liability are under current market conditions, including assumption about risk. Thus, the retention of an asset or the discharge of a liability is not relevant in the measurement of fair value (IASB, 2012). Three levels of fair measurement are employed quoted (unadjusted) prices, observable and unobservable inputs.

The financial crisis of 2007-2009 sparked the interest of researchers to the consequences of fair value accounting, and since then, its application has received more critics than positive comments. In literature, the application of fair value accounting has given rise to different interpretations and till date, no shared agreement on the effects of fair value accounting measure on 2007-2009 financial crises. The argument over the role played by fair value accounting during the crisis is still an impending issue for academic researchers. The severity of the global financial crisis and the economic financial meltdown, made many critics to blame fair value accounting for the occurrence (Sodan, 2020). One of the reasons for the critics of fair value accounting measure within the circumference of the financial crisis, was the suspected pro-cyclicality effects that, fair value accounting could have on financial statements. Although the role of FVA in determining the financial crisis has not been studied widely and also, till date, it is still inconclusive and uncertain of the presumed pro-cyclical effect of FVA could have on reliability of financial reporting. However, despite the alleged demerits of FVA approach, there are some important arguments in favour of the FVA. The use of market prices for preparing accounting reports is useful to investors and authorities, as they deliver more relevant information on a firm's current performance. FVA still obtains extensive general support from the accounting profession, standard setters and financial institutions (Catty, 2019). Amidst the conflicting arguments, gave credence to this study to conceptually look at some contending issues in fair value accounting measurement approach. Therefore, the main thrust of this study is to conceptually discuss some unresolved issues in FVA literature, and then respond to the following three questions as drivers of this study. First, what are the specific factors that

undermine the relevance and reliability of fair value accounting? Second, does FVA enhance earnings quality? How promising is FVA? Following this introduction, the remaining part of this study is structured as follow; the concept of FVA, FVA measurement and verification issues, financial instrument measurement, pro-cyclical effect of FVA, FVA versus earnings, conclusion and recommendations.

Total Asset Fair Value

Enaloro and Jayeoba (2013) fair value is viewed from different points. For example, in its statement on Plant, Property and Equipment (PPE) IAS-1 6, assets are to be initially recognized at cost while subsequent measurement should be based on revaluation model. Jafm (2015) Fair Value Accounting (FVA) is an approach to financial reporting whereby profits are measured by comparing revenue with the current replacement cost of the assets consumed in the earning process. The logic of this approach lies in the concept of the going concern. It recognizes in the income statement, the cost which a going concern actually has to pay to replace its expiring assets (Majeed, 2013). They went on to say that the profit figure resulting from FVA closely parallels the maximum amount which a business can distribute to its owners and still be able to maintain the present size and scale of its operations. Glautier (2013), in sharing the same view with Majeed (2013) stated that FVA is concerned with the value of net asset to the business and combines replacement cost, realizable value and present value that should be attached to such assets. They vent further to state that FVA is a modification of historical cost profit to arrive at the surplus after allowing for the impact of price changes on the funds needed to continue the existing business and to maintain its operating capacity, whether financed by share capital or borrowing.

Fair Value Changes during the Year

In May 2011, the Financial Accounting Standards Board (FASB") amended its source document describing the generally accepted accounting principles (GAAP) used by nongovernmental entities in the United States, the FASB Accounting Standards Codification®. The title of accounting standards update No. 2011-4 of fair value measurement (topic 820) amendments to achieve common fair value measurement and disclosure requirements. GAAP and IFRSs, explicitly describes the overall intent of the changes contained in the amendment (Toluwa & Power, 2019). Fair value is still defined as prior to the amendment, as 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. However, changes have been made to the manner in which some of the underlying concepts of valuation are applied to particular types of assets. The highest and best use concept originated with the valuation of real property, although it is a concept that is also used in personal property appraisal. Basically, the highest and best use concept recognizes that real estate and personal property can have multiple uses, and that the value of an asset may change with a change in its use. Determining the highest and best use of an asset relies on an analysis of the current use and potential alternative uses of the property, considering what is legally permissible, physically possible, financially feasible, and maximally productive (Riahi & Khoufi, 2016). For example, consider a piece of highly specialized equipment used in the manufacture and assembly of the finned core of an automotive radiator. This very expensive, highly complex, custom designed and constructed piece of equipment is a valuable asset, allowing for the fabrication of hundreds of thousands of cores each year as part of an operating business. Yet, if taken out of that specific production setting, the unique characteristics of the core assembly machine specific core size, complexity of operation, physical capacity, etc. change its worth to the amount realized from the sale of its common components (controls, transformers and power supplies) and the scrap value of its metallic components. The change from its current use in radiator manufacturing to an alternate use has drastically affected the value.

Financial Performance

Vare (2015) defined financial performance as a relative term measurable in terms of profit, and its has elements that can directly influence performance in the organization. He when further to explain tthat, there are number of ways to measure financial performance, such as: profit margin, earnings per earning ratio, return on sales, cash to asset, return on capital employed, return on assets, return on investment, return on fixed assets, return on operating profit. However, in this study, return on assets (ROA) and profit ensuring financial performance. Return on Assets (ROA) is treated as important measure of a company's earnings performance. The return on assets examines the efficiency of resources employed in business operations. It examines per unit profit is computed as: Assets the higher a company's return on assets, the better management is at employing company's resources in tons analyze the trend in ROA for are this to historical and industrial Profit before tax (PRT) is measured by deducting all expenses from the accrued revenue of a firm. Nwanyanwu (2014) opined that financial performance is measured when comparisons of information contained in the financial statements are made with profits earned using accounting ratios. Tests of profitability focus on measuring the adequacy of income by comparing it with one or more primary activities or factors that are measured in the financial statements. Obida (2012) defined profitability as the ability to make profit from all the business activities of an enterprise. It measures the efficiency of management of an organization's scarce, resources in creating value to the organization. Over the years, the objectivity of profits declared in the financial statements of business firms has resulted in the adoption of various accounting standards. In recent time, the historical cost accounting standards has given way to fair value accounting. Presently, various regulatory bodies, such as the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have adopted the fair value accounting system over historical cost accounting. Although, historical cost accounting reports assets and liabilities at their initial price while fair value accounting reflects the prevailing market price of such asset or liability. It is very clear that the accounting treatments of the various assets and liabilities of a firm have significant impact on its financial statements; and above all management decisions regarding future corporate concerns (Nwanyanwu, 2014).

Return on Equity (ROE)

Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on Equity is a ratio that provides investors with the insight into how efficiently a company (or more specifically, its management team) is managing the equity that shareholders have contributed to the company (Fuhrmann, 2017). It is about the earning capacity by using shareholder's funds. It is the responsibility of managers to effectively manage the equity. ROE explains net earnings by using the equity given by the shareholders. It also indicates the portion of total assets provided by shareholder equity. Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. Because shareholders' equity is equal to a company's assets minus its debt, ROE is considered the return on net assets. ROE is considered a measure of how effectively management is using a company's assets to create profits. ROE is especially used for comparing the performance of companies in the same industry (Brammer & Millington, 2008). ROE considered as an important measure profitability of the company. The higher values generally mean that the company is effective in the generation of income on the new investments. Investors should be compared to the return on the rights of shareholders of different companies, as well as the verification of the trend in the rules of engagement with the passage of time. However, only relying on the return the rights of shareholders and make investment decisions are not safe. The management can be affected in unclear way, for example, when the use of debt financing to reduce capital, there will be an increase in the return on equity even if remain fixed income (Grande, 2011).

Theoretical Review

Alchian and Demsetz (1972) the output of a team is bigger than sum of outputs of individual workers which leads the resource owners to establish cooperative economic organizations that called firms. The main target of the resource owners in establishing the firm is to seize the plus value of the team. However, "team members may shirk" and in order to prevent shirking. Alchian and Demsetz (1972) suggest monitoring team and rewarding them. Nonetheless, it creates a kind of trust problem and requires monitoring the monitor as well. Even if monitoring team has widely accepted by all parties of the market, and has been used as a tool of efficient governance, it is insufficient on its own. Furthermore, agency theory is developed by considering the firms where the company owner is separated from its management, the risk is here that the agent may not work for the best interest of the principal (Jensen & Meckling 1976; Fama & Jensen, 1983). This risk creates agency costs; monitoring, bonding and residual loss.

Empirical Review

There are numerous studies on the relevance of Fair Value Accounting on financial statements, as well as the impact. In this literature review some literatures were considered in this study on the impact of fair value accounting on financial performance of manufacturing firms in Nigeria.

Chidoziem et al (2020) in their study evaluated the effect of fair value reporting on financial profitability and firm value: evidence from quoted deposit money banks listed on the Nigerian Stock Exchange. The study used 13 banks as sample size, the study employed secondary data gathered from published annual reports of eight years from 2008 to 2015. The study employed both descriptive statistics and regression analysis to analyze data. The findings showed that fair value reporting does not significantly affect reported profitability. The study concluded that in order to effectively evaluate financial performance and position, knowledge of fair value is not enough.

Gospel and Akpeekon (2019) carried out a study to examine the relationship between fair value accounting and financial performance of manufacturing companies in Nigeria. The study adopted a descriptive and quasi experimental design. The data employed secondary source which was generated from the annual reports of ten (10) selected manufacturing companies listed on the Nigeria Stock Exchange from 2008-2010. The study used least square method of multiple regressions. The result showed that fair value accounting has a positive and significant impact on both profit before tax, return on assets and return on equity.

Chidoziem et.al (2019) evaluated the effect of fair value reporting on financial profitability and firm value with focus on deposit money banks listed on the Nigerian Stock Exchange Using a sample of 13 banks quoted on the Exchange, the study employed secondary data gathered from published annual reports while descriptive analysis was employed to summarize data collected using SPSS Version 23 software, regression analysis were used to analyze data. The findings showed that fair value reporting does not significantly affect reported profitability. Fair value was however found to affect firm valuation.

Akwu et al (2017) in their study of fair value measurement, depreciation and profitability of listed manufacturing companies in Nigeria employed panel data from the financial reports of manufacturing companies quoted on the Nigerian stock exchange for the conversion periods, 2011, 2012 and 2013 as applicable. The ordinary least square regression technique and t-statistic were used for the analysis. The study revealed that with the use of fair value and historical cost convention, International financial Reporting Standards (IFRS) has an encouraging impact though small on depreciation and in the profit reported.

Olanrewaju (2015) assessed fair value accounting method with a view of determining its effect on historical cost method of asset valuation in public limited companies. The study selected five petroleum companies listed on the Nigeria Stock Exchange. The study adopted descriptive research design using secondary method of data collection.. T-test statistical tool was used in determining

and analysis whether there is significant difference in assets valued under fair value as against historical cost method. The study found that there is significant difference between assets valued at fair value and historical cost method. Findings also show that price level changes was the principal factor responsible for the difference in asset valuation and that financial statements prepared under these methods produced different information for the users.

Onipe et al. (2015) carried out a study to determine the effect of current assets management and financial performance: Evidence from listed deposit money banks in Nigeria. The study adopted an ex post facto research design. The study sample utilizes data from 2010-2014 belonging to 15 deposit money banks operating in financial services sector as listed by the Nigerian Stock Exchange (NSE). In empirical analyses, robust estimator was used. The results of the conducted analyses suggest a positive relation between the cash and bank balances, financial assets held for trading, loans and advances to customers and Return on Asset. Another result of the study, on the other hand, suggests that derivative assets, loans and advances to banks have negative impact on return on asset.

METHODOLOGY

This study determined the relationship between fair value accounting and financial performance of manufacturing firms in Nigeria. The study employed an ex-post facto research design was adopted which involve quantitative methods of data presentation, data analysis and hypothesis testing. The population of study consists of all the listed manufacturing firms in Nigeria but the study selected four companies in Nigeria. The study adopted interval scale of measurement and preceding year basis of sampling, with a sample size of 28 year. Six (6) years each from the four selected manufacturing firms in Nigeria from 2015 to 2021. The source of data was secondary, obtained from Nigerian Exchange Group (NGX) formally known as Nigerian Stock Exchange (NSE). The study adopted multiple linear regression analysis to analyze the data with the help of Statistical Package for Social Science (SPSS) to determine the relationship between the variables to answer the research questions and test the null hypotheses at 0.05 level of significant.

Model Specification

$$FP = f (FVTA, FVCDY)$$

Where:

FP = Financial Performance (ROE)

FVTA, FVCDY = Fair Value Accounting

Therefore,

$$ROE = f (FVTA, FVCDY)$$

The above equation is trans-modified into econometrics form by adding constant term β and error term (ε) in the model below:

$$FP = f (FVTA, FVCDY)$$

$$FP = \beta_o + \beta_1 FVTA + \beta_2 FVCDY + \varepsilon \dots \dots \dots (2)$$

$$ROE = \beta_o + \beta_1 FVTA + \beta_2 FVCDY + \varepsilon \dots \dots \dots (3)$$

Mathematically,

$$ROE = \beta_o + \beta_1 FVTA + \beta_2 FVCDY$$

FP = Financial Performance

FVA = Fair Value Accounting

FVTA = Fair Value of the Total Assets

FVCDY = Fair Value changes during the year

ROE = Return on Equity

β_o = Intercept

β_1, β_2 = Coefficient of the Predictor Variables
 ε = Error Term

RESULT ANALYSIS

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.546 ^a	.452	-.033	160.45912	2.039

a. Predictors: (Constant), FVCDY, TAFV

b. Dependent Variable: ROE

Source: Generated by the researcher from data collected using SPSS

From the results in table 1 showed that R (0.546), R² (0.452) and adjusted R² (-0.033) that measured the proportion of the variations in return on equity (ROE) of dependent variable attributed to total assets fair value (TAFV) and fair value changes during the year (FVCDY) of independent variables implied that, the independent variables explain about 45.2% (percent) of the variation in return on equity (ROE). The remaining variation is the error term and is attributed to other factors not included in the model. The value for return on equity (ROE) is unexcited and very high since the unexplained variation is about 54.8% (percent). The result of durbin-waston statistic of 2.039 showed absence of autocorrelation of the error term. This means that the estimates based on OLS is not spurious. It means that the results of the analysis are reliable for predictions.

Table 2: Model ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3171.266	2	1585.633	.062	.002 ^b
	Residual	1467586.408	57	25747.130		
	Total	1470757.674	59			

a. Dependent Variable: ROE

b. Predictors: (Constant), FVCDY, TAFV

The table above indicated a regression significant P value of 0.002 > F (0.062) indicating that, the overall model is statistically significant at 0.05% of total assets fair value (TAFV) and fair value changes during the year (FVCDY) of the independent variables and return on equity (ROE) of financial performance of manufacturing firms in Nigeria.

Table 3 Model Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	24.162	22.295		1.084	.283
	TAFV	-3.003E-007	.000	-.028	-.203	.840
	FVCDY	-2.109E-006	.000	-.032	-.233	.817

a. Dependent Variable: ROE

The above table indicated that, the p value of 0.840 > 0.05 significant levels between total assets fair value (TAFV) and return on equity (ROE). Therefore, we accept the null hypotheses and reject the alternate which stated that, there is no significant relationship between total assets fair value (TAFV) and return on equity (ROE) of manufacturing firms in Nigeria. It is also indicated that, P-value of 0.817 > 0.05 significant levels between fair value changes during the year (FVCDY) and return on equity (ROE). Therefore, we accept the null hypothesis and reject the alternate which

stated that, there is no significant relationship between fair value changes during the year (FVCDY) and return on return on equity (ROE) of manufacturing firms in Nigeria.

CONCLUSIONS AND RECOMMENDATIONS

This study set six hypotheses and actually achieved them. On the basis of empirical findings above, the study concluded that, total assets fair value (TAFV) and fair value changes during the year (FVCDY) of fair value accounting had no significant relationship on return on equity (ROE) of financial performance of manufacturing firms in Nigeria. Manufacturing firms can make use of total assets fair value and fair value changes during the years in predicting growth rate of earnings per share of financial performance while return on equity should be critically evaluated before using it to predict growth rate of total assets fair value and fair value changes during the year. In line with the findings of the study, the following recommendations were made:

1. Firms should exercise caution in the application of fair value accounting most especially in term of forecasting return on capital employed and return on equity in order to avert the cyclical effect of it.
2. There is need for expansion of the disclosure of information that is prepared on the basis of fair value.

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