A Review of Accounting for Inflation and Current Price Financial Reporting of Manufacturing Firms in Nigeria

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ABSTRACT

Inflation is the most common fact of our time, the single greatest peril to our economic health. Prices of various goods and services have been rising at a very high rate. In the past few years companies have reported very high profits on the one hand but on the other hand, they have faced real financial difficulties. This is so because in reality dividends and taxes have been paid out of capital due to overstated figures of profits arrived at by adopting historical cost concept. This has led to the collapse of many businesses. Money is a measure of value and value changes from time to time so money is a function of value change. The value of a business is its earnings per share (share price). Changing value of' money has resulted in a chaos and distortion while reporting results of economic activities of business enterprises in the manufacturing firms in Nigeria. This study aimed at reviewing the accounting for inflation and current price financial reporting of manufacturing firms in Nigeria. Extant literature was reviewed and analyzed. Findings suggested that changing price level, otherwise called inflation, has a significant effect on current price financial reports of listed manufacturing firms in Nigeria. Thus, recommends that manufacturing firms should report financial statements on the basis of current prices in order to give a more realistic information of their performances.

Key-Words: *changing price level, inflation, current price, manufacturing firms, financial reporting.*

INTRODUCTION

Inflation accounting is that technique of accounting by which the financial statements are restated to reflect changes in the general price level. According to the American Institute of certified Public Accountants (AICPA), "Inflation accounting is a system of accounting which purports to record as a built-in mechanism of all economic events in terms of current cost". Financial reporting refers to standard practices to give stakeholders an accurate depiction of a company's finances, including their revenues, expenses, profits, capital, and cash flow, as a formal record that provides an in-depth insights into the financial information of the company. In

1979, Financial Accounting Standard Board (FASB) Statement No. 33, Financial Reporting and Changing Prices, was issued as an experiment in requiring supplementary information on the effects of Inflation and changes in specific prices (Okezie, 2016).The general tendency in changes of prices of goods and services over a time is called price level change (PLC). The rise in general price level is called inflation (INFA). During the period of INFA, purchasing power of money declines. The fall in the general price level is called deflation.
INFA is a problem that affects all economies and it is typically more severe in the less developed countries (Okowa, 1996). Many conditions have made INFA possible in Nigeria, thus, several factors are identified as being responsible for INFA and its rising rate in Manufacturing Firms (MANUFs) in Nigeria.

LITERATURE REVIEW

Conceptual review

Akpakpan (1994) attributes INFA to two related factors that are responsible for the actions of economic agents;
1. The way Nigeria organizes and conducts the production and exchange of goods and services in the country.
2. Policies used in Nigeria to sustain her chosen system of production, especially, in the MANUFs in Nigeria. The factors condition each other. Beyond creating conditions for selfish manipulations, a system of production that is characterized by private ownership and market direction of activities, induced government policies and policy measures or instruments, intensifies the problem of INFA in the society. Thus, a change from historical cost concept to PLC or INFA accounting has been recommended (Gjerde, 2007). Its advantages may include the following;
(1) It enables the MANUFs in Nigeria to present more realistic view of its profitability because current revenues are matched with current costs.
(2) Depreciation charged on current values of assets in INFA further enables the MANUFs in Nigeria to show accounting profits more nearer to economic profits and replacement of these assets when required.
(3) It enables a company to maintain its real capital by avoiding payment of dividends and taxes out of its capital due to inflated profits in historical accounting.
(4) Balance Sheet reveals a more realistic and true and fair view of the financial position of the MANUFs because the assets are shown at current values and not on distorted values as in historical cost accounting.
(5) When financial statements are presented and adjusted to the PLC, it makes possible to compare the profitability of two concerns set up at different times in the MANUFs in Nigeria.
(6) Investors, employees and the public at large are not misled by inflated book profits because CPFR shows more realistic profits in the MANUFs in Nigeria. Higher paper profits without adjustment for PLC causes resentment among workers and they demand higher wages and also excessive profits attract new entrepreneurs to enter the business. But CPFR helps in avoiding further competition from prospective entrepreneurs.
(7) The financial statements prepared by the MANUFs in Nigeria, adjusted to the PLC, go a long way to improve its social image.
(8) CPFR also have significant effect on the investment market as it helps to establish a realistic price for the shares of a company in the MANUFs in Nigeria.

MANUFs can use some techniques to account for PLC, such as; Replacement cost accounting (RCA) and Current purchasing power (CPP) where, according to Easton & Harris (1991), the index used is the one that is directly relevant to the firm's particular assets, therefore, better than current purchasing power which most of the time gives report on historical cost basis. Aside from the RCA and CPP methods, we still have the current value accounting (CVA) and the current cost accounting (CCA). The CCA is more preferable since it prepares financial statements using current values of individual items ignoring the original cost. This is in-line with CPFR practices. Financial statements prepared under this technique provide a more realistic information and brings to light the difference between profits earned from business operations and the gains arising from PLC (Siyanbola, & Rani, 2013).

The effects of PLC

Income and Wealth: There are two ways to measure the effects of INFA on the redistribution of income and wealth in a society. Gitman, (2004) discuss that, on the basis of the change in the real value of such factor incomes as wages, salaries, rents, interest, dividends and profits of MANUFs, and on the basis of the size distribution of income of the consumers over time as a result of INFA. When there is INFA, it affects MANUFs, which also affects the prices of other goods and services in different ways. But those who invest in debentures, securities, bonds, etc. which carry a fixed interest rate lose during INFA because they receive a fixed sum while the purchasing power of money is falling (Egbunike, 2007).

Production: When prices start rising, it encourages production and producers may earn good profits. Producers may invest more with the expectation to having future higher returns. This tends to increase employment, production and income in the MANUFs. But this is only possible up to the full employment level. Further increase in investment beyond this level will lead to severe inflationary pressures within the economy because prices rise more than production as the resources are fully employed. So INFA adversely affects production after the level of full employment (Hughes, J., Liu, J., & Zhang, M. 2004). The adverse effects of INFA on production can lead to the production of substandard commodities and adulterated products (Slater, 1995). While original and quality products are being hoarded and sold in black-markets. Since there is general rise in prices of goods and services, savings is reduced, discouraging investment and capital formation as well as hindering foreign capital due to rising costs of materials (inputs) which makes foreign investment less profitable (Umeaka, 2003).

THEORETICAL FRAMEWORK

The monetary theory of INFA is of the view that money supply growth is the cause of INFA. This suggests that INFA is proportional to money supply. The demand pull INFA, cash push INFA and mixed demand INFA all points to the fact that INFA is real and should be adequately accounted for in any economy. Okowa (1996) attributes INFA to structural rigidities and supply inelasticity. He also mentions fiscal and monetary responsibility as what increases INFA. Given that INFA could occur as a result of the actions of consumers, producers or workers. Akpakpan (1994) argues that the root causes of the problem are found beyond the actions of the mentioned economic agents. He posits the necessity to examine the factors that determine, induce or permit such actions.

Gbosi (1993) argues that the phenomenon of INFA in Nigeria is caused by the following:-
1. Rapid structural changes in the economy in recent years, the oil that increases money supply.
2. Rapid urbanization which intensifies the demand for goods and services that is in relatively short supply.
3. Expansionary monetary policy adopted by the central bank of Nigeria.

From an industrial point of view, Okowa (1995) attributes INFA to:
1. Corruption mediated decrease in effective labour inputs in the MANUFs in Nigeria.
2. Indiscipline which gives rise to a reduction of effective labour input, this would yield a decline in supply in the MANUFs in Nigeria.
3. Corruptions which mediate a decrease in capital stock in the MANUFs in Nigeria, which will bring about the PLC.

When government spends money without a corresponding production of goods and services, and or ineffective fiscal measures aimed at withdrawing money in circulation, INFA is bound to occur. Such measures can further be extended where government appoints a price control board on national level with its branches in all the states of the federation to peg the prices of certain essential consumer goods like rice, flour, milk and drinks on one hand and building materials or manufacturing goods on the other hand. As stated earlier, the general tendency in changes of prices of goods and services over a time is called PLC. The rise in general price level is called INFA. During the period of INFA, purchasing power of money declines. The fall in the general price level is called deflation. During the period of deflation, purchasing power of money increases. Change in price level means increase or decrease in the purchasing power of money over a period of time. The accounting which considers PLC is called accounting for PLC.
According to Collins, (1997) Accounting for PLC or CPFR is a system of maintaining accounts in which all items in financial statements are recorded at current values. This system of accounting ascertains profit or loss and presents the financial report or position of the business on the basis of current prices.

CONCLUSION

MANUFs are always affected by high inflation which may reduce profits as well as harming the production process. But when organisations adopt the last-in, first-out (LIFO) system of inventory control, there may be positive results in the event of high INFA, because it makes room for possible ways to deduct cost of goods sold (COGAS) by using inflated current costs rather than lower historical costs (Hughes, et.al. 2004).
Money is the medium of expression of values in modern life. Effects of various economic activities are measured and expressed in terms of money. For measuring anything, it is mandatory that the measure itself is constant. Money as a medium of expression of value and measure of economic activity is expected to have a constant value. But this expectation has not been a reality. Constant value of money has remained a very unrealistic assumption (Desai, 2005). Money is a measure of value and value changes from time to time so money is a function of value change. Changing value of' money has resulted in a chaos and distortion while reporting results of economic activities of business enterprises in the MANUFs in Nigeria. Findings suggested that PLC, otherwise called INFA, has a significant effect on financial reports

of listed manufacturing firms in Nigeria. If financial reports must show the true and fair view of the business, then CPFR practices should be encouraged. Thus, recommends that manufacturing firms should report financial statements on the basis of current prices in order to give a more realistic information of their performances.
Further studies should make efforts to empirically test the effect of INFA and PLC in other sectors of the economy of Nigeria.

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