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**THE EFFECT OF HISTORICAL COST ACCOUNTING
ON THE REPORTED PROFIT OF A COMPANY: AN
EVALUATION OF CURRENT COST ACCOUNTING
AS AN ALTERNATIVE REPORTING METHOD**

**EGBE NDUBUISI
PG/MSC/09/54009**

**BEING A DISSERTATION PRESENTED TO THE
DEPARTMENT OF ACCOUNTANCY
FACULTY OF BUSINESS ADMINISTRATION
UNIVERSITY OF NIGERIA
ENUGU CAMPUS**

**IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF MASTERS
OF SCIENCE (M.SC) DEGREE IN ACCOUNTANCY**

SUPERVISOR: DR. UGWUOKE R.O

NOVEMBER, 2014

DECLARATION

I, Egbe Ndubuisi Christian, a post graduate student in the Department of Accountancy with Registration Number PG/M.Sc/09/54009 has satisfactorily completed the requirements for research work for the Degree of Masters of Science (M.Sc) in Accountancy.

The work embodied in this dissertation is original and has not, to the best of my knowledge, been submitted in part or in full for the award of any other Degree or Diploma of this or any other tertiary institution.

PG/M.Sc/09/54009
Researcher

APPROVAL PAGE

This dissertation by Egbe Ndubuisi C. with Registration Number PG/M.Sc/09/54009, presented to the Department of Accountancy in the Faculty of Business Administration, University of Nigeria, Enugu Campus, for the award of masters of Science (M.Sc) Degree in Accountancy, has been approved by:

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(Head of Department)

Date

DEDICATION

To my parents, Mr. and Mrs Egbe Oru Iduma for their love, care, concern, prayers and financial support all through my academic journey.

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ABSTRACT

This study evaluates the effect of historical cost accounting on the reported profit of a company: An evaluation of current cost accounting as an alternative reporting method. In a high – inflationary and distorted economy like Nigeria with high uncertainties, the conventional historical cost method of profit reporting has misled many companies into liquidation since it has been found inadequate in accounting for the uncertainties. The persistent nature of this phenomenon has called for a fair and suitable reporting method of profits in times like this. The profits retained by the company are affected by costs and appropriations of income. A higher cost will leave little income for appropriation and to be retained in the company. The amount of profit will depend on the reported method in operation. The historical cost method makes low depreciation to be charged while leaving high profit for tax and dividends payments. In the light of the above, the objectives of the study were to determine the nature of relationship between historical cost methods and reported profits of manufacturing companies in Nigeria, ascertain the extent to which current cost method affects the overstated profits made by manufacturing companies in Nigeria and to determine how current cost accounting can be used to remedy the inherent deficiencies in the historical cost methods. An ex post facto research design was adopted in this study. The population of the study comprises forty-eight (48) manufacturing companies in Nigeria under 24 industrial classifications. Financial statements of these companies are published annually for public consumption. But due to time lag, ten(10) manufacturing companies quoted in the first tier securities market were randomly selected . Secondary sources of data were used in the study. The data were obtained from the statistical bulletin of the Central Bank of Nigeria and Annual Reports of the Nigerian Stock Exchange. Depreciation charge served as the independent variables while Profits of the firm served as the dependent variables and were used to measure the profitability, capital adequacy ratio and improvement of shareholders` equity in the selected sampled manufacturing companies. The Pearson Product Moment Correlation Coefficient was employed to test the hypotheses one while Chi-Square were employed to test the hypotheses two and three. These were done at the alpha level of 5% with the aid of the SPSS 17.0 statistical software. The results of the study discovered that there is a positive significant relationship between historical cost method and the reported profits of companies in Nigeria , Current cost methods does not significantly affects the overstated profits made by these companies and the study recommended that: there should appropriate decision for current cost accounting method to be adopted so as to improve their capital maintenance level, and there should be further research on the causes of further research on the effect on historical cost accounting on the reported profits of companies in Nigeria.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The major objective of any business organization is to make profits and continue in business, but what they face in the course of doing their business and the method of accounting they use in reporting their profits may make this noble objective to be unrealistic particularly during the inflationary period.

Inflation in Nigeria in the last one decade has seriously distorted and created uncertainties in the economy to the extent that there has been economic and productivity decline, infrastructural and institutional decay, high poverty level, low investors confidence, wide spread of corruption, high exchange rate, depreciation of domestic currency, high rate of unemployment, high debt profile, general fall in the purchasing power of naira, high level of crime rate leading to cost of business operations, fall in industrial capacity utilization to about 20 percent, price instability, decline in GDP and growth and general increase in cost of living. Inflation rate in the last 14 years shows thus: 1997: 8.5, 1998:10.0, 1999:6.6, 2000:6.9, 2001:18.9, 2002:12.9, 2003: 14.0, 2004:15.0, 2005:16.5, 2006:13.5, 2007:10.5, 2008:5.4, 2009:11.6, 2010:11.5, 2011:13.9. Federal Office of Statistics (2005), Central Bank of Nigeria Annual Report (2006), and [www.indexmundi.com/Nigeria/inflation-rate-CIAworldfactbook\(2011\)](http://www.indexmundi.com/Nigeria/inflation-rate-CIAworldfactbook(2011)).

The economic and environmental uncertainties in the Nigerian economy have made business in Nigeria to be constantly under serious threat especially the inflationary trend which has now become a noticeable phenomenon. This has also called for; or caused changes in the value of our currency in which accountants and even the accounting bodies find difficult to agree. Operating costs of business in the economy keep rising thereby making the existence and survival of the business organizations to become difficult which eventually lead to insolvency and winding up of many of them (Ola:2001). Doubt has a serious role to play in this, but more serious is a situation where the environment makes it difficult to report the actual profit of the business at a given period resulting in the pay outs from the business to be based on subjective (assumed)

profit. The method of profit reporting during the period of changing prices is another case in point. Whereas the reporting method does not change frequently for the sake of principle of consistency but the reporting units in the accounts keeps on changing. The question now is how can these two be reconciled to arrive at the actual profit made for the period? The use of historical cost accounting for profit reporting makes past costs to be charged against current revenue resulting in overstatement of the reported profits. Not only charging past cost, but also the past costs being under charged make the accounts to be misleading.

This situation was aggravated throughout the 1990s by the accelerated rate of inflation; as a consequence, products and services were under- rated, thus producing fictitiously high” paper” profits which the company shared out between the employees as wages, its shareholders as dividends and the taxation authorities as corporate tax. The rate of liquidation of business during this period was a great concern to the accountants, professional bodies and the Government to the extent that it generated a lot of debates. The relevance of the financial reports is based on historical reports of accounting practice has continued to generate intensive debate at different for a in the world. This is especially true in a high – inflationary and distorted economy like Nigeria. Except for few items (Assets revaluation, a major example), financial information reported by many Nigerian companies are stated under the historical cost convention. This policy is clearly stated in the annual reports and accounts of these companies as part of the significant accounting policies adopted in the preparation of financial statements.

This method has led many businesses into liquidation in the last one decade and has caused a great concern to the accountants, professional bodies and the Government. The Nigerian government in collaboration with the CBN in order to find solution to this in 2001 directed her fiscal policy towards bringing inflation rate to a single digit figure while the CBN primary objective of monetary policy is to ensure price stability. The focus on price stability derives from the over whelming empirical evidence that it is only in the midst of price stability that sustainable growth can be achieved (Ola: 2001).

Debates on inflation have subsided, but the issue is not dead. Debates on this issue are as perennial as the grass; as soon as they are continuous and significant increase in the level of prices, the debates will be resumed with much vigor. Therefore, the issue has to be addressed in spite of the cessation of debate at this time. Williamson (1980) and Jennings (1993), in their argument against the continuous use of historical cost accounting, concluded that it includes the fact that historical cost accounting values can relate to transactions that could be a year old, 10 years old and as much as 100 years old. It is true that some businesses have old equipment and old stocks (Inventories) that are still working but out of date and so the balance sheet is showing out date values. It is readily apparent that financial statements prepared in accordance with the historical cost concept have always been defective to the extent that:

- a) They fail to reflect the impact of changing price level:
- b) Assets are disclosed in the balance sheet at unrealistic values.
- c) The profit and loss account does not bear proper charges, particularly for depreciation and cost of materials consumed (Jennings 1993).

According to Ola (2001), the method of historical cost accounting does not make provision for the changes in the purchasing power and as such, the continuous usage of the system leaves these questions unanswered:

- a) How are we affected by the steeply rising cost of Assets replacement?
- b) How much lower is our profit if we take into account the cost of replacing the base stocks we need to remain in business?
- c) What money do we need to set aside to finance our higher values of work-in-progress?
- d) To what extent can we sensibly rely upon supplies to share the burden of inflation?
- e) To what extent is the erosion of our capital resources mitigated in the longer term by the repayment of loans and over draft in depreciated currency? And
- f) Is the real wealth of shareholders reflected in the account?

These are some of the questions that the current cost accounting is trying to answer. The existence of inflation and its persistent nature calls for an alternative to the historical cost accounting method of profit reporting. One of the feasible alternatives to the historical

cost accounting is the current cost accounting method. Current cost accounting method has as a basic principle, that operating profits should only be measured and reported after the capital the capital of the firm has been maintained (Dean, 1994).The emphasis on capital maintenance is highly imperative in today's business environment if the business must survive and succeed. (Glanter and Under down, 1987).

However, Capital cannot be maintained in isolation of the principles, Concepts and postulates employed in the measurement of business income. Since the income of the business directly affects the shareholders' capital, it therefore follows that the method employed in measuring the income may equally and directly influence the value of the shareholders' capital. Traditionally, accounting measures profits by comparing sales with cost of sales and overheads measured at their historical costs Goudekot, 1990. This method is often referred to as the historical cost accounting method. The method is objective and in times of relatively stable price level works well.

However in recent years when a rise in the general price level of over 25% is experienced (CBN, 2005) the profession has recognized the need for some amendments to the historical cost accounts. The basic problem with the historical method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenses measured on historical cost values (Berliner.1993).This measurement approach reduces the operating ability of the company's assets and does not maintain the capital of the firm (Baxter 1984). The basic objective of current cost accounting is to provide management and shareholders with more useful information about financial viability, returns on investment, pricing policy, cost control, distribution and gearing decision.

The rate of inflation over the years as published by the Federal Office of Statistics (FOS) and www.Indiexmundi.Com (Nigeria/Inflation-rate-CIA World fact book) keeps on rising thereby introducing complexities into the simple profit measurement of revenue less cost. Among the many methods used in profits reporting during price changing period are: Replacement cost Accounting (RCA), Revaluation of Assets (RA), Accelerated depreciation and LIFO, Current Purchasing power Accounting (CPP),

Replacement price Accounting (RPA), Current cost Accounting (CCA), and Continuous Contemporary Accounting (COCO). Despite these stipulations and legislation and in the light of inflationary trends, published financial statements over the years have failed to comply with the professional codes and legal standards. The studies empirically examine the deficiencies of the historical cost accounting on reported profit during inflationary periods and suggest modified current accounting as an alternative method of profit measurement in a distorted economy like Nigeria.

1.2 Statement of the Problem

Corporate financial reports rest upon the assumption that management is reporting to absentee investors who have no independent means of learning how their representatives are discharging their stewardship. Therefore the need to furnish them with useful and guided accounting information cannot be over-emphasized. Thus, the method used in the preparation of accounting information becomes an important consideration in the analysis of such information to meet users' needs.

In an economy such as Nigeria, what method of reporting should be adopted or used so as to present a true and fair view of the state of affairs of the businesses of a company? Nigerian economy has experienced different inflationary rates in recent times, and it is doubtful if the historical cost accounting serves adequately in reporting a true and fair view of the affairs of the company. This has posed a great challenge to the accounting profession, government and management of businesses to effectively measure and report the operating results of companies. In order to guarantee the going concern concept, the historical cost which is the traditional reporting method does not accommodate price changes. Selling prices are stated at current prices while the cost of assets used in generating the sales are stated at historical cost; that is acquisition cost. This results in overstated profit leading to overpayment of tax and dividends.

Fixed assets and stock of goods also face the same problem. The conventional practice is to record the fixed assets at their acquisition cost throughout their useful life. Depreciation is also charged based on the acquisition cost of the assets irrespective of the current replacement cost of such assets. This equally leads to overstated profits and

overstated value of assets which may make replacement difficult. The main problem of rising prices is that the financial statements prepared on historical cost basis do not show true and fair view of the results of operations as shown in the income statement and financial position as shown in the balance sheet shown in the statement. The consequence is that the cost of goods sold does not approximate the actual goods sold neither does distributed income relate to actual current profit instead ,dividend payout turns to capital reduction. Similarly, the annual depreciation charge may not represent the true proportion of assets used up in the proportion of the income for the period. The continuous use of historical cost accounting method during the period of changing prices makes performance analysis to be misleading. Moreover, investment decision is hampered because both local and foreign investors do not have a real picture of actual operation of the organization. Taking these deficiencies of historical cost method into consideration, necessary adjustment to accommodate the effect of price changes became paramount.

1.3 Research Questions

In the course of this study, the following research questions were formed:

1. What is the relationship between historical cost method and reported profits of manufacturing companies in Nigeria?
2. To what extent does current cost method overstate profits made by manufacturing companies in Nigeria?
3. How could current cost accounting be used to remedy the inherent deficiencies in the historical cost methods?

1.4 Objective of the Study

The broad objective of this study is to examine the impact of inflation on reported profit of financial statements of Nigerian quoted companies. In order to achieve this purpose, the following specific objectives are:

1. To determine the nature of relationship between historical cost method and reported profits of manufacturing companies in Nigeria.
2. To ascertain the extent to which current cost method affects the overstated profits made by manufacturing companies in Nigeria.

3. To determine how current cost accounting can be used to remedy the inherent deficiencies in the historical cost methods.

1.5 Research Hypotheses:

The following are the research hypotheses:

1. H_0 : There is no positive significant relationship between historical cost method and the reported profits of manufacturing companies in Nigeria.
2. H_0 : Current cost method does not significantly affect the overstated profits made by manufacturing companies in Nigeria.
3. H_0 : Current cost accounting cannot be used to remedy the inherent deficiencies in the historical cost methods.

1.6 Scope of the Study

In accordance with the Nigerian stock exchange classification of companies listed on the exchange, there were 48 companies listed on the Nigerian Stock Exchange as at December 2005 (Cashcraft, 2010). For this researches.10 firms were randomly selected each from these sub sectors;- Livestock feed plc, Dunlop plc, Guinness Breweries plc, Nigerian Wire Company plc, Cap plc, Unilever plc, Niger Flour Mills plc, Glaxo SmithKline plc, First City Aluminum plc, Avon Crown Caps and Containers plc all in manufacturing sectors, thus the sample size is 10 companies.

The technique adopted in this research is the stratified random sampling method. This method involve the selection of the sample based on classes or groups with each group or stratum having some definite characteristics or features (Onwumere, 2005; Douglas, William and Robert 2002). 10 companies was selected based on this techniques from 48 manufacturing companies in the Nigerian Stock Exchange classification of firms quoted on the exchange excluding the Banking, Insurance, Foreign listings and other Financial Servicing subsectors. The exclusion of these subsectors was based on them representing the lending end of the Nigerian financial system as well as the desire of the researcher to localize the research to Nigeria.

In furtherance to the study, 10 manufacturing companies quoted in the first tier securities market (Financial Times, 2005), under 24 industrial classifications, publish their annual financial statements for public consumption. Financial statements of these companies published in the year 2001,2002,2003,2004, 2005, 2006 and 2007 are used as the basis of analysis. The base year of 2001 is chosen because the International Financial Report Standard (IFRS) (2004) requires that or states that “Accounts of companies should be adjusted for effects of price changes when the country is experiencing inflation – rate of 16 percent, and above. The inflation rate in 2001 was 18.9 percent and it was that year that the government expressed genuine intention to curb inflation rate to a single digit figure. Historical financial statements for 2001 were adjusted for effects of price level changes using the Consumer Price Index (CPI) for 2001. Previous studies by Peterson (1993) and Baran (1996) indicated that the CPI is a reliable deflator in the restatement procedure. Davidson and Weil (1995) equally used CPI in adjusting the historical financial statements for effects of price changes in a study carried out in United Kingdom (UK).

1.7 Significance of the Study

The relationship between historical cost accounting method and current cost accounting method on the reported profits of companies is a relatively new area of study although gaining ground due to greater interest amongst government, management, investors, scholars, academia etc. The study will lend support to the government, management, investors, financial institution, as well as add to the literature. This research work is imperatively expected to significantly fill the lacuna in Nigeria and beneficial to the following:

1. The Government

The end result of this study is expected to benefit policy makers in government and its agencies in understanding better, the impact of operating profit of companies in manufacturing sector in Nigeria. This will help in formulating policies on how to maintain production, sales and distribution indices high. It will equally help government have more focus on the areas to intensify reforms to attract investment which boost our

economy and move towards redirection of strategies, programmes and policies that will enhance managers, shareholders, public and private participation, income generation, employment and infrastructural development.

2. The Academia

The result of this study to the body of academic world, will form part of the needed information, motivation will be geared towards widening the scope of the knowledge of historical cost accounting method and current cost accounting methods on profit reporting and to other researchers in same area. And will thus serve as a spring board for further researchers in the vital area of study with regards to manufacturing sector.

3. The investors:

The end result of this study is expected to benefit investors greatly in the sense that the annual financial statements published in the first tier of the Nigerian stock exchange market is solely to attract and encourage investors in Nigeria for instance. So, these manufacturing companies whose shares are traded and are requested by the law to always publish their financial statement for the public's consumption were measures agreed and adopted by the stock market commission to serve investors with useful information about companies.

1.8 Limitation of the study

In the course of carrying out this research work, the researcher encountered a lot of difficulties in gathering of necessary materials. To achieve this purpose, materials were sourced from the internet, CBN annual and statistical report among others. The constraints of a single –digit inflation rate of 18.9 in 2001 of the country and the period (2001-2007) financial statements under study (time-lag) limits the researcher's scope of knowledge in various ways which cannot be enumerated here. The manipulatable nature of secondary data equally imposes limitations on the findings of the work. Notwithstanding the undeserved constraints, this study utilized the relevant available data gathered from the internet and other sources to carry out the research. Apparently, the reliability and validity of the sources of data significantly determine the outcome of the study.

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CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Accounting exists primarily as a means of computing a residuum, a balance, the difference between cost (as efforts) and revenue (as accomplishment for individual enterprises). This difference reflects managerial effectiveness and is of particular significance to those who furnish the capital and take the ultimate responsibility. The link between management and investors is the financial report and corporation reports should rest upon the assumption that a fiduciary management is reporting to absentee investors who have no independent means of learning how their representatives are discharging their stewardship (Turner, 2000). There cannot be a true presentation of this report without an understanding of price movements, knowing that the major impact on both financial theory and the practice of financial position and decision making has been the economic instability, especially in prices. The objective of financial reporting is however called to question in period of rising prices of goods and services. This is the period when the value of assets carried in the books of the company do not bear true figure to the operating ability of the company. During this period, profits, measured on historical cost accounting basis are overstated and assets value understated. It has been suggested that to eliminate the overstatement of profit, cost of sales and depreciation would need to be adjusted for updated report profit (Ola, 2001).

Gray (1993) and Slimming's (1974) also argued that rising costs would have diminishing effects on working capital needs, as a whole which goes beyond the effect on inventory. For example, during period of rising costs, the amount of cash required by a firm to replace inputs would increase while debtors pay later at the historical cost values. The argument can be extended for purchase of stock on credit while prices are rising. The use of monetary working capital adjustment (MWCA) to adjust for cost of sales and other items raises some questions. How do we determine what monetary items are part of the monetary working capital? There could be difficulty of distinction because of closeness of items that could be incurred. Which index should be used? Cost index or sales index? The arguments for a general index only solve part of the problem. Indeed, the use of

monetary working capital adjustment is difficult and opinion differs as to its desirability. Secondly, with respect to balance sheet, the depreciation historical cost of an asset does not represent a current value of resources employed in business. The method of revaluation of fixed assets using modified historical cost accounting may not solve all the problems. Thirdly, financial statements reported under historical cost convention can give misleading impression of growth and profitability of the reporting companies.

Users require information useful for decisions about the future while the historical cost accounting is based on the past. Performance employed and its derivative is more or less meaningless. The criticism is particularly apparent in the case of 5 years summaries included by listed companies in their annual reports and accounts statistics computed on the basis of historical cost accounting such as turnover, earnings per share, asset employed can give a distorted impression of a company's performance and position.

Financial information should be prepared and presented in such a form that will be relevant to the users' needs, reliable, timely and comparable. The effect of changing prices would certainly make financial statement prepared under historical cost convention difficult to satisfy their needs. Expressing financial information at current values and reporting them timely would reduce the lag between decision making period and the time of preparing and reporting financial statements.

Goudek (1990), examines the methods used in accounting for processing and presenting information to be through three principal statements. These are the profit and loss account and cash flow statements. These statements and their underlying financial accounting procedures interpret all the events in monetary terms, in accordance with the basic accounting conventions which limit the recognition of events to those which can be expressed in monetary terms. Wood and Sangster (1999) explain that the financial accounting statements have meaning in so far as money itself is meaningful in the context in which information is communicated in those statements. The profit and loss account is concerned with establishing the net profit from the transactions of the period under review, and the balance sheet is concerned with presenting the financial position of the business as at the date of the balance sheet. Whatever is implied by these two statements, much of their meaning depends upon the significance of the money value attached to the

various items on which information is given. If an asset, for instance is shown at a valuation of N1000 in the balance sheet, does this mean that it could be sold for N1000 or does this mean that it originally cost N1000?

Baxter (1984) asserts that money measurements of accounting events and items are essentially a process of valuation. Valuation enter into accounting measurements in to sense – first, the money standard of measurement is itself unstable though time value of one naira today does not have the same value of one naira yesterday or one naira to tomorrow, since the purchasing power of money over goods and services changes. Second, the use of money measurement in accounting implies a choice between one of the several different valuation basis.

2.2 Theoretical Framework

A fundamental controversy underlying much of the uncertainties over accounting practices is the question of whether or not accounting measurements should reflect the historical cost of an asset or liability or some measure of its “current value” which may be measured in a variety of different ways. The FASB (Financial Accounting Standard Board) while adhering to the historical cost concept in its decision nevertheless has adopted a number of fair value based standards to address these uncertainties in the area of profit reporting. These standards affects the selection of financial reporting strategies and practices by managers, the preparation of financial statements by accountants, and interpretation of financial statements by the users of financial statements/accounting reports issued by business enterprises and the effective application of these standards is based on the understanding of profit measurement theories. These theories include the following:

2.2.1 Wealth, Income and Capital Maintenance Theory

Edward (1995) and Friedman (1988), agreed that a change in the purchasing power possessed by an individual represents a change in his or he capital capacity to engage in transaction. This is also true of business entities. The stock of purchasing power possessed by an entity in this sense depends on two factors:

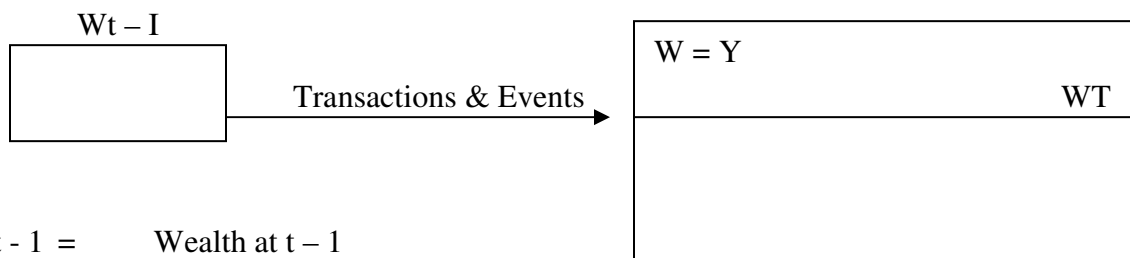
- a. The general level of prices, and

b. The amount of money or money equivalent at its command.

Firms usually do not keep their financial resources in cash; rather they invest them in another asset. If the market prices of such asset change the capacity to command other goods and services will change also. Furthermore, if the value of money as expressed by the general level decreases over a period, the amount of money or its equivalent at the end of the period will have less purchasing power than at the beginning. Therefore, it is important that, in financial reporting, any change in these two factors should be identified and accounted for.

Income in a real sense is the change in purchasing power possessed by the entity between two points in time (Gay: 1993). Accounting income provides indications of the earning power and future cash flows of company which determines its dividend paying ability. The expected value of the its shares will depend largely on its paying ability

The nature of income and wealth is illustrated in the diagram below:



W_{t-1} = Wealth at $t - 1$
 W_t = Wealth at t
 W = Change (increase) in wealth between $t- 1$ and t
 Y = Income

In addition to being useful to managers, accounting income is also important for steward purposes, wage and price fixing and dealing with government (tax authorities). Capital is essentially a financial notion which has reference only to the available or the actual (Slimmingles, 1994). In this sense, the money equivalent to the net represents capital at the beginning of an accounting period. Since money is wanted for its general money or its equivalent represents the capacity of the holder to engage in transactions. It is only logical to say that at least this capacity must be maintained before the can be any surplus or improvement in position.

The basic rationale for the concept has been that the capital of the entity should be maintained intact before distributing dividends to the owners in order to safeguard the interests of creditors. Capital maintained is increased by identifying the capital to be maintained when determining the results for the reporting entity. Different accounting models use different basics for this purpose, for the historical cost model the capital to be maintained is the nominal capital, for the CPP model and the COCOA model, it's the purchasing power of the initial capital; for the CCA model, it is the physical capital (Mathews and Pevera, 1996).

A current cost profit and loss account includes a number of items and found in one based on the historical cost convention. The actual number will depend on the chosen capital maintenance concept which may be "operating capital maintenance" or financial capital maintenance". In operating capital maintenance, the most convenient way of measuring company's output is by using a proxy its net operating assets. So a company will only be deemed to have made profit if it has maintained the level of its net operating assets. Net operating assets include company's fixed assets, stock and all monetary assets less all liabilities. There are four "current cost adjustments which might appear in a current cost profit and loss account and which may be regarded as "converting" a historical cost profit into a current cost profit. The first three are current cost adjustments (operating) and the fourth is the gearing adjustments.

- 1) **Cost of Sales Adjustment (COSA):** This is the difference between current cost of goods sold and the historical cost.
- 2) **Depreciation Adjustment:** This is the difference between the depreciation charges for the year based on its historical cost.
- 3) **Monetary Working Adjustment (MWCA):** Monetary working capital may be defined as cash plus debtors less current liabilities. In order to operate, most companies need to invest in monetary working capital as well as fixed assets, and then they might need also to hold a certain level of cash and sell on credit. An increase in price will mean that a company would have to increase its investment in monetary working capital and the purpose of the MWCA is to show the additional investment required to cope with price increase.

- 4) **The Gearing Adjustment:** The gearing adjustment is the link between the current operating cost profits attributable to the equity shareholders. It depends on the assumption that part of the additional funds required to be invested in the business as a result of increased price will be provided by long term creditors. Financial capital maintenance focuses on the shareholders and whether their interest in the company has increased in “real” terms, which are after taking account of inflation. This approach deals with both changes in specific prices and inflation and may be described as a real terms current cost system.

If it is assumed that no capital is introduced or withdrawn during the period, the “real term” profit can be found as follows:

- a. Measure the shareholders funds at the beginning of the period based on the curve cost assets.
- b. Restate that amount in terms of naira purchasing power at the balance sheet data by use of a relevant index of general prices (such as the retail price Index (RPI).
- c. Compare the restated amount from (b) with the shareholders funds at the end of the year based on the current cost of the assets. If shareholders fund at the end of the period exceed the restated figure from the beginning for the period, a “profit” has been made, which ASC handbook as “total real gain’ (Lewis and Pendrill, 1988).

2.2.2 Realization Hypothesis

Realization is one of the rules of conventional accounting which dominates the determination of profit and it may be referred to as converted into money or a claim to money. Among the standard, postulates of accounting, realization is one that profit is “realized” gains and that therefore profit emerges when the revenue from which it is derived. The point of realization is often described as the point of sale in the ordinary course of a business is affected, unless the circumstances are such that collection of the sales price is not reasonably assured. AAA (1995) recommended that the concept of realization could be improved with the application of the following criteria:

- i Revenue must be capable of measurement
- ii The measurement must be verified by an external market transaction and
- iii. The crucial event must have occurred.

The AICPA (1996) also expressed the same view, when it said; revenue should ordinarily be accounted for at the time a (sale) transaction is completed, with appropriate provision for uncollectible accounts. Mathew (1996), says realization is the formal recognition of revenue in computation of profit and the use of realization test usually results in revenue being recognized at the point of sales. However, there are variations in the timing of revenue realization and recognition depending on the circumstance. In other words, revenue realization and recognition can occur simultaneous or at different point in time.

Conventionally, profit is regarded as the difference between sales revenue or selling prices of the products sold and the historical cost of earning that revenue. On this basic, all unrealized or unsold assets are differed cost yet to be marketed with future revenues and should be valued at cost. If the price of an asset continues to rise over a number of accounting periods under the realization race there will be large amount of profit at the time of sale. But obviously the full amount if not solely due to the events of that period. If the purpose is to discover the extent to which the financial position of a firm in relation to the rest of the environment has changed from one accounting period to another, depends on the realization test in, likely to obscure the discovery. Gold (1980. sterling (2001), argues that some of the logical inconsistencies in the rules underlying historical cost valuation methods are related to this concept.

2.2.3 Value Differential Theory

Ijiri (1997), has classified accounting values into basic types: sacrifice values and benefit values; sacrifice values or such as historical cost or replacement cost, represent the amount of disunity or sacrifice necessary to obtain economic goods and services. Benefit values, such as selling price, net realizable value, or discounted present value represent the utility or benefits obtainable from consuming goods and services. The classification clearly and closely reassembles the dichotomy between labor theory, value and utility theory of value in economic theory. It is also essentially the same as the prices. Ijiris' terminology is used here because it is more descriptive of the underlying nature of the values and because Ijiri uses these terms in conjunction with the term "value differential".

Income measure are based on the difference between two accounting value. They can be referred to, then, as value differentials. Historical cost income is based on a benefit – sacrifice differential, since it is measured the difference between realized selling price, which are benefit values, historical costs, which are sacrifice value. Continuously Contemporary Accounting “Chambers (1996) income is based on benefit differentials since under this system of accounting, income is the difference between the net realizable value of net assets at the end and the beginning of the accounting period. Replacement cost income is composed of two types of differentials where holding gains are included in income. Operating profit, the difference between realized selling price and replacement costs, is a benefit – sacrifice differential, whereas the holding gain n the asset held during the period is a sacrifice differential since it is difference between the two replacement costs.

The basic objective of economic activity is to maximize the difference between benefits and sacrifices. A benefit – sacrifice difference is regarded as income because it indicates that the basic objective has been accomplished. Benefit differential also can be regarded as income because they indicate improvement or progress towards the basic economic objective. A positive differential means that the expected benefits of the obtainable from the resource of the enterprise have increased.

2.2.4 Matching Theory

The matching principle plays a key role in the process of determining periodic accounting profits. Paton (2000) describes the matching concept as the association of effort and accomplishment – AAA (1995) recommends that cost should be related to revenue realized within a specific period on the basis of some correlation if these costs with recognized revenue. It is also states that it is important to have some rules for marketing financial gains and losses during a period, for otherwise it would be impossible to prepare income statement. In conventional accounting the notion of matching is used in the sense of matching particular events and their financial magnitudes or numbers representing monetary amount regardless of the time at which they occur, or if the significance of the underlying financial facts, for instance, depreciation based on historical costs may reflect

cost levels prevailed years ago when naira had a vastly different purchasing power depending on the inventory method in use, cost of goods sold may represent a figure which is quite current or if may not. In such case, the current revenue in naira may be matched against expenses which are far from current event.

Furthermore, matching might just as well be interpreted as identifying events which have a bearing on the financial position of an entity within each period should be identified and accounted for Chambers (1995). The consistent application of the matching notion requires that all gains made during a period whether realized or not should be brought into account and matched with all the losses incurred during the period. The income statement for any given period should reflect all the revenues properly given accounting recognition and all cost written off during period, regardless of whether or not they are the result of operations in that period. Accordingly, it can be argued that first gains and losses should be taken include those resulting from the dealing in both short term and durable inventories; and second, any change in the general level of prices during the period should be brought into account (AAA: 1986).

2.2.5 Asset Theory

Historical cost is the actual purchase price plus incidental costs incurred in getting the fixed assets in a condition and position ready for initial use/commercial production (Weirs, 2005). Asset in common form is any object tangible or intangible that is of value to its possessor, which can be consumed, appreciated or trade off overtime.

Under U.S. generally accepted accounting principles (U.S, GAAP), the historical cost principle dictates that most asset and liabilities should be recorded at their historical cost. As such, a tract of land which was purchased 50 years ago for N10, 000.00 may be worth N1m today, but it will be recorded on the balance sheet at its historical cost of N10, 000.00. The historical cost principle is used because of its reliability and freedom from bias when compared to their fair market value principle (Tearney 2004). The historical cost of an asset can usually be determined with exactitude so long as the records showing the amount paid for the asset are still available. But difficulties are involved in the determination of historical cost of some kinds of assets such as trading stock- whether

stock should be valued on the basis of average, FIFO etc. The problem is more actual when trading stock involves work in progress and finished goods as the question of the extent to which over heads should be included in the stock figure must be considered. Similar problem arise when determining the cost of fixed assets which are constructed by a firm for its own use. There is another class of asset for which it may be difficult to find a historical cost. These are assets that have been acquired through barter or exchange, a special case of which assets are purchased in exchange for shares in the purchasing company. In such instances, it may be necessary to estimate the historical cost of asset acquired.

This is actually done by reference to amount that would have been realized had the assets which had been given in exchange been sold for cash. In some cases, it might prove to be extremely difficult to make the necessary estimates as there may not be market in the asset concerned. The historical cost of assets purchased together is also difficult to determine. For example where a company purchase the net asset of another company or unincorporated firm, for accounting purpose, it is necessary to determine the historical cost of the individual assets and liabilities which have been acquired and this involves an allocation of the global for inflation in most countries are prepared on the basis of historical cost without regards to changes in the general level of prices. The individual assets, liabilities, shareholder, equities, revenue, expenses and gains and losses are therefore stated at cost at the time at which these items were originated while the impact of inflation is ignored significant change in the purchasing power of money mean that financial statements unadjusted for inflation are likely to be misleading. Amounts are not comparable between periods, and the gain and loss in general purchasing power that arises in the reporting period is not recorded. Financial statement unadjusted for inflation does not properly reflect the company's position at the balance sheet date, the results of its operation or cash flow.

Fair value accounting (also called replacement cost accounting or current cost accounting) was widely used in the 19th and early 20th centuries, but historical cost accounting became, more widespread after values overstated during the 1920s were revised during the Great Depression of the 1930s. Most Principles of historical cost

accounting were developed after the Wall Street Crash of 1929, including the presumption of a stable currency. One of the basic principles in accounting is “The Measuring Unit Principle”. The unit of measurement in accounting shall be the base money unit of the most relevant currency. This principle also assumes the unit of measurement is stable; that is changes in its general purchasing power are not considered sufficient important to required adjustment to the basic financial statements. Under a historical cost-based system of accounting, inflation leads to two basic problems: first, many of the historical numbers appearing on financial statement are not economically relevant because prices have changed since they were incurred. Second, since the numbers in the financial statement represent naira expended at different points of time and in turn embody different amounts of purchasing power that are simply not additive.

Relevance of value Theory Includes:

- The objective of financial reporting based on a conclusion that investors and creditors are primarily interested in assessing the amount, timing and uncertainty of future cash inflow to the equity and eventually to them. Information is relevant if it has the capacity to make a difference to that assessment.
- It provides information about benefits expected from assets and burdens imposed by liabilities under the economic conditions when they were acquired or incurred.
- It reports gains and losses from prices changes only when they are realized by sale or settlement, even though sale or settlement is not the event that caused the gain or loss.

Price to the individual assets and liabilities are separately identified in the accounting system. Any balancing figures represents the amount paid for all the assets and liabilities not separately identified in the accounting system and it is described as goodwill., such allocation is made usually by using “fair values” which results in the individual assets being valued at their replacement cost and liabilities being valued at their fair value.

If the assets has been received in consideration of issuing shares/bonds or notes payable, historical cost is recorded at fair market value of share/bonds or notes payment. For example, machinery is bought in return of 10,000 shares which have a market value of

N12 each at that time, then the historical cost of the machinery is N120,000.00 (any subsequent change in value of those shares is counted for separately). If a group of assets are purchased for a single lump sum, the cost paid is allocated among various assets on the basis of their market value. If an asset has been received for another monetary (non) asset, historical cost is recorded as the fair market value of the asset given up or the asset acquired whichever is more evident. In general, cost incurred to improve an asset should be capitalized (that is added to the historical cost price), whereas expenditure that simply maintains a given level of service should be treated as an ordinary expense and the historical cost of an asset which is taken to be the original acquisition cost is adjusted to account for change in the value or purchasing power of money between the date of acquisition and the valuation date (Richard, 1996).

2.2.6 Value Theory

Value according to Weirs (2005) is the monetary amount associated with an asset, liability, and transaction event for the purpose of accounting and usually reflecting the amount which the thing could be exchanged. An asset value is an important component of a company's total value. In historical cost accounting, historical cost is the original value of an economic item and does not generally reflect current market value. Different accounting standards may require that the carrying value of an asset (or liability) be updated to market price (market-to-market valuation) or some other estimates of value that better approximates the real value. Accounting standards may also have different methods required or allowance (even for different types of balance sheet assets or liabilities) as to how the resultant change in value of asset or liability is recorded as part of income or as a direct change to shareholders' equity.

Historical cost assumes a stable monetary unit only with regards to constant real value non-monetary items in low inflationary economics. Financial statements unadjusted to report amounts can be computed based on internally available information about prices in past transactions without reference to outside market data (FASB, 2000).

2.2.7 Depreciation Theory

SSAP 12 (Statement of Standard Accounting Practice) defines depreciation as “a measure of the wearing out, consumption or reduction in the useful economic life of a fixed assets whether arising from usage, effluxion of time or obsolescence through technological or market changes and that depreciation should be allocated valuation of the assets to each accounting period expected to benefit from its use. Teemu (1991) says depreciation represents the periodic allocation of the cost of tangible long-lived assets over their useful lives. During each accounting period (year, quarter) a portion of the cost of these assets is being used up. In other words, it is the transfer of a portion of the asset cost from the balance sheets statement during each year of the assets life. Depreciation should be based upon the historical cost of an asset expect that, where an asset has been revalued, subsequent depreciation should be based on the revalued amount.

In historical cost accounting, historical cost is the original monetary value of an economic item and the value this item carry in the balance sheet is affected by depreciation. The historical cost will be equal the carry value if the case has been no change recorded in the value of the asset since acquisition. The calculation and reporting of depreciation under historical cost accounting is based upon two accounting principles:

- 1. Cost Principle:** This principle requires that depreciation expenses reported on the income statement and the amount that is reported on the balance should be based on the historical (original) cost of the asset. It should not be based on the cost to replace the asset or the current market value of the asset.
- 2. Matching Principle:** This principle requires that the assets cost be allocated to depreciation expense over the life of the asset. In effect, the cost of the assets is divided up with some of the cost being reported on each of the income statements issued during the life of the asset. By assigning a portion of the asset cost to various income statements. The accountant is matching a portion of the assets cost with each period in which the asset is used.

Hopefully, this also means that cost is being matched with the revenue earned by using the asset. Historical cost depreciation charge means higher profit for the period and positive projection of cash flow especially as no money is actually paid out at the time in which the expense is incurred. SSAP 12 emphasizes that all fixed assets covered by the

standard and which have a finite useful economic life should be recorded at their historical cost and depreciated accordingly. The assets specified as being outside the scope of this standard and cost are:

- i. Investment properties
- ii. Goodwill
- iii. Development cost and
- iv. Investments.

2.3 Alternative Approaches to Historical Cost Accounting

2.3.1 Provision for Increased Cost of Asset Replacement

Under this method, a provision is made for the increased cost of asset replacement due to inflation by transferring a proportion of reported surplus to a reserve specially created for the purpose. One of the major defects of this procedure is that it says nothing about the effects of the inflation on balance sheet figures; it is solely concerned with making increased provision for assets replacement. This method was popular in the UK in the early 1950s.

2.3.2. Revaluation of Assets

The object of this method is to bring the book value of individual assets up- to- date by period revaluation so that they approximately charges in markets values of those assets. In countries such as UK, Australia and New Zealand, revaluation is not specifically required by company legislation, but the flexibility of the law permits it adoption, whereas some others, countries such as Argentina, Brazil and Chile, recent legislation has made revaluation compulsory in respect of certain types of asset (Matthew, 1996).

2.3.3 Accelerated Depreciation and LIFO

Accelerated depreciation methods and LIFO inventory methods are piecemeal approaches to inflation accounting. These two methods have almost the same effects on financial calculations. Although both methods results in more current costs being matched against current revenues, they do not cause any change towards current amounts in the balance sheet. In a period of rising prices, these practices will have the effect of

creating secret reserves to the extent of the difference between the past cost and the current costs as at the date of the statement. In the case of LIFO, it tends to understate the closing figures for stocks and hence to give a lower current ratio than if the prices used were contemporary prices. Similarly when prices are falling, it tends to give an artificial high current ratio. Neither of these methods makes any concession to the diminishing purchasing power of the monetary unit. Finally, adjustment of one or two elements of expense such as depreciation and cost of goods sold while leaving others unadjusted is not sufficient to represent the impact of price changes on a firm's finance (Matthew, 1996).

2.3.4 Current Purchasing Power Accounting

Under the Current Purchasing Power accounting (CCP), non-monetary assets are adjusted by an index of changes in the general level of prices, all items in the income statement are adjusted by using the same index, gains and losses in monetary items, that is cash, receivables and payables which results from changes in the purchasing power of the other conventional items in the income statement. According to the provisional statement of accounting, Standard 7 9PSSAP 7), the method is justified on the ground that, "it is important that management and other users of financial accounts, should be in a position to appreciation of effects inflation on the business with which they are concerned".

The degree of objectivity under CPP accounting is virtually the same as in Historical Cost Accounting (HCA), apart from the selection of the index. Ease of verification is also similar. The effective of this method is to maintain purchasing power capital instead of financial or nominal capital. The income figure becomes somewhat better guide to economic performance than that yielded by the historical cost model because CPP accounting attempts to measure income in such a fashion that it represents the maximum amounts of resources that could be distributed during a given period, while maintaining the firm's purchasing power at the end of the period as it was at the beginning. However, the adjusted cost figure for particular assets may be good indicators of their current value, although it is usually better in times of inflation than the adjusted cost figure.

However, CPP accounting fails to reflect the full effects of the price changes occurring in a period of inflation because it covers only one of the two effects of inflationary price changes mentioned above. Under CPP accounting it is assumed that no change in purchasing power arises from the investment in non-monetary assets. Accordingly, it qualifies only the purchasing power losses or gains arising from net non-monetary assets. From example the PSSAP7, says holders of non-monetary asset is measured/assured neither to gain nor lose purchasing power by reason only of inflation as changes in the price of these assets will tend to compensate for any changes in the purchasing power of the naira”.

But it is improper to make a general assumption such as the above because it is true only, if the prices of the assets of any firm tends to move in the same rate as the general price level index. It is also false to assume that firm having the same monetary items is affected equally by the events of any inflation period when the composition of their non-monetary item is different. If the aim is to discover how the purchasing power of an original investment has changed over a period, adjustments to original costs by using a price level index are not going to help make that discovery because it does not give any information about the purchasing power of the net asset at the balancing date. To provide that information, it is first necessary to find the amount of money or money equivalent of assets possess independently of the book figure, but CPP accounting does not require such a thing. The events of recent years have demonstrated the most serious faults of historical cost accounting and inadequacies of the CPP approaches. For example, if the price of an asset has been moving in the opposite direction to the general price level, such an adjustment does not make any sense of all. Under CPP accounting, there is no change in the principle on which the financial statements are conventionally prepared and they will continue to be based on the historical costs. Therefore many of the existing defects of conventional accounting reports are likely to continue, in spite of the process of conversion (Mathew, 1996).

2.3.5 CPP – Converting the Accounts

In practice, companies maintain their books of prime entry in terms of historical cost, and indeed it could only be possible to write up the books in CPP units if a CPP rate prior to the commencement of the year were used. Moreover, in most cases where CPP has been proposed as a solution to the problems of accounting in terms of inflation, it has been argued that the CPP accounts should be very time – consuming task to restate the books of prime entry of any, but the smallest and the most simple business in CPP terms, it is necessary to find a method of preparing a CPP accounts on the basis of the historical cost account. There are number of ways in which this can be done, the most common being the ‘net charge, method, which consists of four stages:

1. The opening historical cost balance sheet is converted to CPP units at the opening balance sheet dates. Non-monetary items are converted by the factor.

$$\frac{\textit{Index of opening balance sheet date}}{\textit{Index at date of acquisition or revaluation}}$$

While monetary item will require no adjustment, the CPP equity will then be the difference between CPP assets and CPP liabilities. This step will only be necessary in the first year of preparing CPP accounts; therefore, the closing CPP balance sheet of the previous year will give this information.

- ii. The opening CPP balance sheet is restated from CPP at the beginning of the account period, to CPP units at the end of the accounting period, by applying to the figures calculated at stage 1, the factor.

$$\frac{\textit{Index of closing balance sheet}}{\textit{Index at opening balance sheet}}$$

This process was termed “updating” in SSAP 7. In the first year of presenting CPP accounts, stage I and II can be combined by multiplying all non-monetary items by the factor, in future transactions. If the aim is to discover the financial results from events

which have occurred up to a particular point in time; it is necessary to find out the financial position at that time. Financial position is the position of a firm in respect of its present assets and equities. However, one could argue that the RPA balance sheet does not represent the current financial position, because, in any form of RPA accounting, the figures given for assets are not representative of money equivalents of assets held. Asset amounts under RPA are the prices that a firm would have to pay if it did not already have those assets.

Such amount are dependent upon the present intentions of the managers, for example, assets are valued at replacement price if replacement is intended, and at net realizable value if replacement is not through to be necessary to the continuance of operations. The intentions of manager do not determine the present state of a firm. It is the relationships that exist between the firm and the rest of the environment, quite independent of the manager's intention, which determines the present state of a firm. The relevance of the figures arrived at on the basis of managers intentions to discover the consequences of what happened in the past could also be questioned. As Gray and Wells (1993) states: Replacement cost is irrelevant to ex-post measure of a firm present financial position in respect of assets actually currently possessed. If income is a measure of the change a firms' position between two points of time (that is, an increase in its wealth) then replacement cost is also irrelevant to that measure (P. 12).

2.3.6 Current Cost Accounting (CCA)

Current cost accounting attempts to capture the effects of inflation on assets value (and liabilities) by reporting them at their current replacement cost i.e. the cost of obtaining an identical replacement. The CCA model is aimed at

- a. eliminating from operating profit those gains arising on stock appreciation and
- b. Charging by way of depreciation an amount based on the "value to the business" of the asset consumed during the accounting period.

Value to the business is calculated by reference to replacement price, either by reference to the specific market price or by expert direct valuation. In some cases, appropriate price indices specific to some particular class of assets may be used, particularly for less

significant items. In those instances where a company would not logically replace an asset, for example where replacement cost exceeds the higher of net realizable value or the present value of future cash flows expected to accrue from the asset, a different method could be adopted. However, current cost will be equal to the replacement price of the asset in the majority of cases.

$$\frac{\textit{Index at balance sheet date}}{\textit{Index at date of acquisition or revaluation}}$$

And all monetary items by the factor

$$\frac{\textit{Index at closing balance sheet date}}{\textit{Index at opening balance sheet date}}$$

The updating process is only required where the CCP date is the closing balance sheet date; clearing where the same CPP is used for both the beginning and the end of accounting period, no adjustment is needed

- iii. The closing historical cost balance sheets are converted to CPP by applying to the non-monetary items the factor;

$$\frac{\textit{Index at closing balance sheet date}}{\textit{Index at date of acquisition or revaluation}}$$

Again, the CPP equity will consist of the difference between CPP assets and CPP liabilities

- iv. The difference between the opening and closing CPP equity, adjusted for dividends and equity capital introduced will be the CPP profits for the year. This profit figure can be analyzed by applying the appropriate factors to the historic profit and loss account, and introducing an item for gains or losses on holding monetary items (Ola, 2001).

2.3.7 Replacement Price Accounting

Accounting systems designed to account for current value or changes in specific prices are collectively called current value accounting. These includes: Replace Physical Assets (RPA), Current Cost Accounting (CCA), and continuously Contemporary Accounting (COCOA). Much of the discussion on current value accounting has been centered on different version of RPA, the object of which has variously been interpreted as “to replace physical assets” to replace physical productive capacity” to replace operating capability” RPA model is aimed at charging the current replacement cost of factors of production, particular invention and plant services, to gross revenue. Under this system, any holding gains arising from the restatement of assets at replacement prices are not included in income calculation but are treated as reserves not available or distribution.

Unlike HCA, which ignores specific price changes, the CPP accounting, which supposes that the specific prices of all non-monetary assets change at the same rate, RPA take changes in the prices of particular assets into account? But as a method of representing the full consequences of inflationary price changes, RPA does not escape the criticism of being partial. It is partial because it tends to regards the effect of inflation on the significance of the monetary unit in which all financial statements items are represented, and to deal only with the rising purchase costs to a firm of engaging. The CCA model views income as the amount of resources that could be distribution during a given period, while maintaining a company’s productivity capacity or physical capital. One way to achieve this is disclosure of current cost accounting information.

2.3.8 Basic Disclosure

Both historical cost and current cost information must be disclosed either by:

- a. Maintaining historical cost based accounts with supplementary current cost based account or
- b. Maintaining current cost based account with supplementary historical cost based information.

2.3.9 Current Cost Profit and Adjustment

Current cost profit is determined in two stages: at the first stage, current cost operating profit is aimed at and represents the surplus contributed by the ordinary activities of the business, before interest and taxation but after allowing for changes on the funds needed to continue the existing business and to maintain its operating capabilities.

At the second stage that part of the current cost profit attributable to shareholders is ascertained by taking cognizance of the way the business is financed. At this first stage, historical cost operating profit is converted to a current cost basis but the application of three main adjustments for:

- Depreciation
- Cost of sales
- Monetary working capital and are secondary
- Fixed assets disposals

The second stage involves the application of a gearing adjustment to the current cost operating profit to convert it to a figure of current cost profit attributed to shareholders. The purpose of the adjustment is to make allowance for the impact of price changes on the funds needed to maintain the net operating assets of the business. The depreciation adjustment is the difference between the proportion of the value to the business of the fixed assets consumed and depreciation calculated on the historical cost basis. The cost of sale adjustment is the difference between the value to the business of stock consumed in the period and its cost calculated in the historical basis. The monetary working capital adjustment is the variation in finance needed for monetary working capital purposes as a result of changes in the inputs of goods and services used and financed by the business. Monetary working capital is defined as trade debtors, prepayments, trade bills receivable and stock not subject to a cost of sales adjustment, less the aggregate of trade creditors, accruals and trade bills payable to activities. Items of capital nature are excluded.

Together, the cost of sales and monetary working capital adjustments allow for the impact of price change on the total amount of working capital used by the business in day to day operations. The fixed assets disposals adjustment is the difference between the historical cost and the current cost value to the business of the gearing adjustment s the

proceeds of disposal in each case. The cost adjustments are abated by an amount representing that proportion of the adjustments financed by borrowing.

2.3.10 Current cost profit and loss account

The standard specifies the minimum disclosures as: Current cost operating profit/loss; Interest income on net borrowing used in the gearing Calculation; Gearing Adjustment; Taxation; Extraordinary items; Current cost profit/loss attributable to shareholders; Reconciliation between (historical cost) profit before interest and tax and current cost operating profit/loss; Individual adjustment; Depreciation; Cost of sales; Monetary working capital.

2.3. 11 Current Cost Balance Sheet

Where current cost accounts are supplementary to historical costs accounts a summarized current cost balance sheet is permissible, disclosing the various items on the following basis.

Item	Basis
Land, buildings, plant etc and Stock subject to a cost of sales Adjustment.	Value to the business
Investment in associated companies	Either (a) at appropriate proportion of their net assets or (b) at directors' estimate of (a).
Other investments	At director; valuation
Intangible assets (including Goodwill)	At estimated value to business
Goodwill/capital reserve on consolidated of subsidiary companies account	Various bases according to circumstances (SSAP 16)
Liabilities, current assets (excluding stock dealt with above).	On historical cost basis

2.3.12 Current Accounts

In the current cost balance sheet, reserves should include revaluation surpluses (or deficits) together with the previously mentioned current cost adjustments.

2.3.13 Group Accounts

The parent company of a group falling within the scope of SSAP 16 should prepare current cost group accounts but need not produce such accounts for itself where historical accounts are the main accounts.

2.4 Requirements for the application of current cost accounting method

Ross (1990), looks at Current Cost Accounting (CCA) as a methodology originally designed for financial reporting in times rapidly changing prices where traditional Historical Cost Accounting (HCA) is considered inadequate. This section details the various approaches to CCA, valuation methodologies used in CCA, adjustments to be made on account of CCA and implementation of it:

2.4.1 Approaches for Current Cost Accounting

The Financial Accounting Standards Board (FASB) and international Accounting Standards (IAS) (2004) prescribed two approaches to CCA, which differ in their consideration of “Capital Maintenance”. Capital maintenance means the manner in which capital of the company is viewed for determining profit Miller (1991), Ross (1990). Capital can either be viewed in operational terms (company’s capability to produce goods and services) or in financial terms (the value of shareholders’ equity interests). Operating Capital Maintenance (OCM) concept require the company to have as much operating capacity at the ends of the period as at the beginning. Financial Capital Maintenance (FCM) considers that financial capital for the company is maintained in real terms at the same level as at the beginning of the period.

2.4.2 Advantages of current cost accounting

Current costs accounting is expected to have the following advantages over historical accounting:

- The current cost represents the amount the firm would have to pay currently to obtain the asset or its services; therefore, it represents the best measure of the value of the inputs being matched against current revenues for predictive purposes.
- It permits the identification of holding gains or losses, thus reflecting the results of asset management decisions and the impact of the environment on the firm not reflected in transaction.
- The current cost represents the value of the asset to the firm if the firm is continuing to acquire such asset by the enterprise.
- The summation of asset expressed in current terms is more meaningful than the addition of historical costs incurred at different time periods.
- It permits reporting of current operating profit, which may be used to predict future cash flows.

One of the advantages of the current cost concept is that some objectivity has been lost: unless the assets currently sold in the market are identical in all respects to the assets held, some subjectivity must be applied in transferring current exchange prices to the owned assets. Also, current costs might not represent the current value to the enterprise. If the firm were required to pay the current costs, it might be economically advantageous to acquire other assets forms instead. The present value of the benefits to be provided by the asset may not be equal to the current or replacement cost of the asset. This is particularly true when technological changes have incurred in the demand for the product. For example, if the demand for the product has declined significantly, the specialized equipment required for its production will have declined in service value to the firm; the depreciated cost of acquiring similar equipment is not a good measure for the service value to the firm. From the interpretational point of view, Hendrickson and Breda (1992) see the current cost concept to be more relevant than the purchasing-power concept. That is, costs related by the use of probably closer to current values than are historical costs adjusted for general purchasing power changes.

2.4.3 Valuation for Current Cost Accounting:

The calculation of current costs involves the following steps: Valuation of Assets: Valuation of assets is a major element of the current cost accounting exercise. The assets can be valued as shown below overleaf. The current cost reflects the business value of the assets. The business value is lower of deprival and net replacement cost. Net replacement cost is the cost of replacing asset with a similar characteristics and age. The deprival value represents recoverable value of the asset to the organization, which is higher of net realizable value and economic value. Net realization value is the net value of asset if it were sold. Economic value is the net present value of the future cash flows from the asset. Normally, net replacement cost of the asset is used as the current cost measure. The net replacement cost of an asset is determined as follows:

Indexation: For each class of asset, price indices are created by analyzing trend of prices over a period of time. These price trends are further modified using inputs from external sources like the General Price Indices (GPI), etc. A base year is chosen and price trends over the year are compared to the base price. For the newer technologies, base year is set to the first year of expenditure.

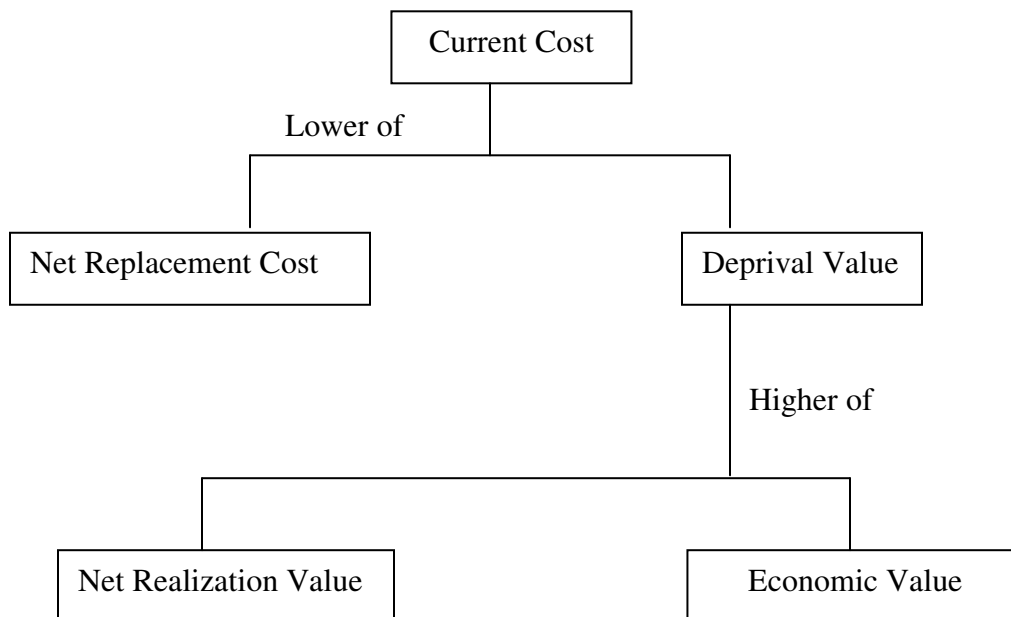


Fig. 2.1: Valuation for Current Cost Accounting:

Absolute value:

At times, the indexation method may not be feasible for the data or other issues. Hence, it may be more reliable to use physical and unit prices to derive an absolute valuation. In situation where there is a technological change, existing would not be in an identical form. This may happen because the asset is no longer manufactured or its capacity and functionality have significantly updated. In such cases, value of Modern Equivalent (MEA) is taken which is value of capacity and functionality.

2.4.4 Current Cost Accounting Adjustments

Ross (2000) prescribes the following adjustment to be made making necessary asset valuations for current cost purpose.

a) Depreciation adjustment

The charge to the profit and loss account for depreciation should equal to the value of the fixed assets consumed during the period. When the assets are valued on the basis of Net Current Replacement Cost, which may increase/decrease during the year, the charge is based on Net Replacement Cost for the period. Hence, supplementary depreciation to be provided to cover up the difference between current historical costs of asset, as described below: $(Rate\ of\ depreciation \times Current\ cost\ of\ fixed\ assets) - Historical\ cost\ depreciation\ for\ the\ year$. The result here gives the supplementary depreciation. The total current cost depreciation (the sum of historical depreciation and supplementary depreciation charges) will not be equal to the replacement cost of the asset at the end of its life because charge in asset cost in intermediate years has to be accounted for. This difference in depreciation is adjusted by providing for “backing depreciation”.

b) Cost of sales adjustment (COSA)

COSA represent the difference between the value to business of the stock consumed during the period and its historical cost. $COSA = (Closing\ stock - operating) - Average\ index\ for\ the\ period\ (closing\ stock/closing\ index - opening\ stock/opening\ index)$. The stock figures to be taken are the historical cost figures. For service-oriented industry with no raw material consumption, the COSA should not generally make significant difference to the Profit & Loss.

c) Monetary working capital adjustment (MWCA)

Monetary Working Capital Adjustment reflects the amount of additional or reduced finance needed for monetary working capital as a result of changes in the prices of goods and services used and financed by the business. In times of rising prices, a business needs more funds to finance monetary working capital, monetary working capital, is the sum of

1. Trade debtors, prepayment and trade bills receivable plus
2. Special category of stock not subjected to COS.
3. Less trade creditors, accruals and trade bills payable

Cash is not being taken into account. Only that part of bank balance and overdrafts that fluctuate with the volume of stock or any other item mentioned above are to be taken into account,

$$MWCA = \frac{(\text{closing monetary working capital} - \text{opening monetary working capital})}{\text{Average Index for the period} \left(\frac{\text{closing monetary working capital}}{\text{closing index}} - \frac{\text{opening monetary working capital}}{\text{opening index}} \right)}$$

The adjustment for MWCA is done in balance sheet by creating a special current cost reserve.

d) Gearing Adjustment

Gearing adjustment reflect the impact structure of an organization on profit. The pay out to borrowings/loans is not affected by the changing prices. Hence, if a company is financed by external loans, it will be benefited during period of inflation as its payout is decreased in real terms during inflation periods. Gearing adjustment is calculated by expressing the net borrowings as a proportion of the net operating assets and multiplying with the total current cost adjustments. Net borrowing is the excess of: The aggregate of all liabilities and provisions fixed in monetary terms other than those included in MWC and other than those, which are in substance, equity capital.

2.4.5 Continuous contemporary accounting (COCOA)

The COCOA model is based on the adaptive behavior of business entities, which implies a continual attempt by them to adjust to the changing environmental circumstances. The rationale for COCOA can be summarized as follows. Adaptive behavior is essential for the attainment and maintenance of given levels of satisfaction of the expectations of the

interested parties associated with the entity. In the last analysis, survival of the entity depends on the amount of cash it can command. To continue in business a firm must have the capability to act in the market or to engage in transaction. This capability is represented by its financial position, which is the relationship between the money amounts of its assets, liabilities and owners' equity. In a market economy, the money amounts of assets and liabilities can be determined objectively by reference to market prices. But the only way to find current cash equivalents of assets and, hence, the capability to act in the market, therefore, calls for knowledge of the cash and cash equivalents of the entity's net asset. According to chambers (1996), "the single financial property which is uniformly relevant at a point of time for all possible future actions in markets is the market selling price or realizable price of any or all goods held".

The COCOA model requires the revision of asset values to their current cash equivalents (defined as their market resale price of current cash equivalent course of business) at the end of each period. The price variation adjustments arising from the asset revaluations are combined with the trading results in arriving at the periodic income. In addition, an adjustment is also made for the effects of general price level change, called the capital maintenance adjustment, which also forms part of the income determination process. The capital maintenance adjustment is arrived at by multiplying the opening total of net assets by the proportionate change in the general price index during the period. For example, if opening net assets were ₦100, 000 and the index moved from 100 to 110 during the period, the adjustment would be.

$$\frac{\text{₦}100000}{100} \times \frac{10}{100} = \text{₦}10000$$

This would be debited to capital maintenance adjustment and credited to capital maintenance reserve. Income is the sum of the total net sales revenue, price variation adjustment and capital maintenance adjustment. Since each set of financial statements is expressed in the current or dated naira applied at the end of the period, COCOA is more logically consistent than any of the other accounting models. While it attempts to eliminate the distortions caused by general price level changes, it also reflects the changes in specific prices. The question of additively is considered to be a key factor in support of COCOA. A prominent feature of this system is its demand that only a single characteristic, the current cost evaluation of assets and liabilities, be measured. It is

argued that the purchase price of an asset cannot be added to an amount of cash if the total is to be meaningful. The total must pertain to the firm's ability to enter and engage in transactions to be able to buy and sell.

Another feature is that, under COCOA, the financial statements are allocation free. The income statement is not a report of changes in allocated amounts, but of asset inflows and changes in the exit values of a firm's assets and liabilities in a given period. Net income displays the amount of change in purchasing power of the net asset, excluding additional investments by and distributions to owners. However, most accountants seem to think that COCOA is too radical. It has been criticized for using exit prices for assets on the grounds that there may be disputes where assets are unique, not readily sold or subject to major price variation depending upon the quantity sold or the combination in which assets are sold. It has also been criticized for what is described as divergence from reality in situation where large and potentially truthful assets are treated as having zero value because they do not have a selling price. Another criticism directed against the COCOA model is that it ignores the concept of value in use. The advocates of Historical Cost Accounting believe such value is represented by acquisition cost whereas those of Current Cost Accounting believe it to be current cost. There have been criticisms against the definition of assets under COCOA. Chambers defines an asset as the "severable means in the possession of an entity". Critics find the stipulation of severability or exchangeability to be unduly restrictive.

Chambers believes that something that cannot be sold separately, such as goodwill, does not help the firm assess its capability to adapt to a changing environment. Critics claim that exchangeability emphasizes only one way to ascertain value. A firm can consider an asset to have value because of its use in the business rather than its sale. The general meaning of economic value has to do with an object's scarcity and utility, not its exchangeability. In defense, chambers argue that although in principle every asset has a value in exchange and a value represents the firm's capability to act in the market, to buy things, to pay debts at a given date and so on. Value in use is basically a calculated amount of a present expectation. It represents beliefs about the future, not facts of the present. Exchange value is determined by the market, not the owner. (Chambers: 1996).

COCOA model has also been criticized for being subjective. This, of course, is common criticism against any current value accounting system. But it is interesting that research studies show that market prices are more objective than the methods under generally accepted of accounting principles. The aspect of accounting for price changes that has been the most controversial has been which concept of capital maintenance to use and the related treatment of monetary items. The concept underlying the systems of historical cost/constant naira accounting is financial capital measured in units of constant purchasing power. The concept of capital maintenance underlying the current cost accounting systems is physical capital or operating capacity. However, considerable variation exists among countries on how this concept is applied. Under COCOA, the concept of capital maintenance relates to real purchasing power.

2.5 Empirical Review

Musa and Yinka (2012) investigate the comparative value relevance of historical cost accounting and inflation adjusted accounting information in Nigeria. Historical cost financial statements of a sample of companies obtained from the Nigerian Stock Exchange were restated using the Parker 1977 approach and instrumental variable equations were constructed to adjust the independent variable for measurement errors. Regression analysis has been used to measure the joint effect of the earning numbers on security prices. Our results show that historical cost information has the potency of distorting, though not significantly, the accounting information provided to decision makers. Our findings also show that historical cost information is more value relevant than inflation adjusted accounting information. However, the value superiority was not found to be statistically significant. Furthermore, our findings show that the information content of inflation adjusted data beyond those of historical cost have statistically significant incremental explanatory power over and above those of historical cost. Consequently, it is recommended that policy makers in Nigeria should encourage firms to provide inflation adjusted information to compliment, rather than replace, the conventional historical cost financial information provided in annual reports.

Effiong et al (2011) conducted a study on the correlation and differential influence of historical cost and current cost profits on the operating capabilities of the firm. The financial statements of thirty-one Nigerian Companies were surveyed and adjusted for

effects of price changes using the Consumers' Price Index (CPI). Correlation influence between the historical cost profits on the operating ability of the firm was measured and established on one hand and that of current cost profit on the other hand. Differential impacts of the method of profit measurement on the operating capability of the firm was equally measured and established. The weighted value of students' distribution – t, HC reveals a correlation which is materially significant between profits and operating ability of the firm. Equally, the F-test result reveals substantial differential impacts of profits measured on historical and current cost bases on the operating ability of the firm during periods of rising prices. Companies interested in maintaining equal operational strength during periods of changing prices are to adopt appropriate basis of profit measurements commensurating the impacts of price changes for the sustenance and survival of the firm.

Andrew (2011) carry out a study on explores the trading incentives of financial institutions induced by the interaction between regulatory accounting rules and capital requirements by investigating insurance companies' trading behavior during the recent financial crisis. According to insurance regulation, life insurers have a greater degree of flexibility to hold downgraded instruments at historical cost, whereas property and casualty insurers are forced to re-mark many of their downgraded securities to market prices. Using firm-level insurance company transaction and position data, we study the implications of this accounting difference, and document direct evidence of 'gains trading' associated with historical cost accounting during the financial crisis. When faced with severe downgrades among their holdings in asset-backed securities (ABS), life insurers largely continue to hold the downgraded securities at historical cost and instead selectively sell their corporate bond holdings with the highest unrealized gains. This is particularly true for insurers facing regulatory capital constraints and with high ABS exposures. This behavior is largely absent among property and casualty insurers; they instead disproportionately sell their re-marked ABS holdings. Finally, we find that the gains trading among life companies induces significant price declines in the otherwise unrelated corporate bonds that happen to exhibit high unrealized gains.

Bessong et al (2012) examine the effects of fair value accounting and historical cost accounting on the reported profits. However, since the major objective of any business

organization is to make profit and continue in business, what they face in the course of doing their business and the method of accounting they use in reporting their profit may make this noble objective to be unrealistic particularly during inflationary period. Data were collected from both primary and secondary sources and presented and analyzed using ordinary least square. The study revealed that both historical cost and fair-value accounting have significant effect on reported profit. Conclusively, Based on the findings of the study, it is concluded that the amount calculated as depreciation, charged as taxes and paid as dividends greatly influence the operating profit of the company. This simply means that the method of profit measurement will greatly influence the amount charged as taxes, depreciation and dividend on the profit of the company. The study recommended that companies should prepare their financial report using both historical cost and fair-value methods simultaneously. This will allow the companies to know the true financial position of their companies before declaring dividend and other benefits.

John and Jumoke (2013) conduct a study on the Value measurement and disclosures in accounting is further effort and method to objectively determine quality of financial reporting which have continued for many decades. Quality characteristics are the bedrock on which accounting theories are formulated, since it is important to prepare and present financial statement with a view to meeting its objectives. Although, this study is literature approach, having explored rationale for fair value accounting, IFRS 13 sets out a framework for measuring fair value; and requires disclosures about fair value measurements. To increase consistency and comparability in fair value measurements and related disclosures, the IFRS 13 establishes a fair value hierarchy that categorizes into three levels the inputs to valuation techniques. The process of valuing an instrument to its fair value depends on how easy it is to determine a price for that instrument. Since fair value is the price at which a willing buyer and seller agree to trade, finding the right price is important to valuation.

Karle (2008) examines the causes and consequences of investment property firms' choice to use the historical cost or fair value model to account for their primary asset, real estate. Our examination exploits the European Union's adoption of International Financial Reporting Standards, which require firms to make this choice under *IAS 40 – Investment*

Property. We hypothesize and find evidence that firms are more likely to choose the fair value model when the firm's pre-IFRS domestic standards permitted or required fair values on the balance sheet, when ownership is more dispersed, and when the firm exhibits a greater commitment to reporting transparency. We also find some evidence of opportunism, as firms adopting the fair value model report larger fair value gains than comparable "as if" figures for firms choosing the cost model. Finally, we find limited evidence that firms choosing the fair value model have lower information asymmetry and greater liquidity than those choosing the cost model. Overall, our results reveal the occurrence, causes, and consequences of variation in firms' reporting choices when differing accounting treatments are permitted

Inder and Myung-Sun (2003) compare the relative explanatory power of fair value and historical cost in explaining equity values. Using the fair value disclosures made under Statement of Financial Accounting Standards (SFAS) No. 107 and SFAS No. 115 by bank holding companies (BHCs) over the 1995–98 period, For our entire sample, we are unable to detect a discernible difference in the informativeness of fair value measures collectively relative to historical cost measures. However, for small BHCs and those with no analysts following, we find that historical cost measures of loans and deposits are more informative than fair values. Anecdotal evidence indicates that loans and deposits are not actively traded and often involve more subjectivity with respect to the methods and assumptions used in estimating their fair values. In contrast, fair value of available-for-sale securities, which are more actively traded in well-established markets, explains equity values more than historical cost. Taken together, our results are consistent with the notion that fair value is more (less) value relevant when objective market-determined fair value measures are (not) available. More importantly, our results suggest that simply requiring fair value as the reported measure for financial instruments may not improve the quality of information for all BHCs unless appropriate estimation methods or guidance for financial instruments that are not traded in active markets can be established.

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CHAPTER THREE

METHODOLOGY

3.1 Research Design

According to Onwumere (2005), a research design is a kind of blueprint that guides the researcher in his or her investigation and analyses. The research design adopted for this research is the *ex-post facto* research design. The adoption of this research design hinges on two reasons

Firstly, the study relies on historic accounting data obtained from the financial statements and accounts of the 48 quoted firms in the Nigeria Stock Exchange, as such the event under investigation had already taken place and the researcher does not intend to control or manipulate the independent variables. The inability of the researcher to manipulate these variables is a basic feature of *ex-post facto* research design. (See Onwumere, 2005) thus, it perfectly suits this research.

Secondly, as described by Kerlinger (1970), the *ex-post facto* research design also called causal comparative research is used when the researcher intends to determine cause-effect relationship between the independent and dependent variables with a view to establishing a causal link between them, also led to the adoption of this research design. Hypothesis 1 was tested using pearson product moment correlation analysis, which according to Douglas, William and Robert (2002) is an impact test used to establish a cause-effect relationship while Hypothesis 2 and 3 were tested using Chi -square.

3.2 Sources of Data

The issue of data is at the very centre of research and also the nature of data for any study depends entirely on the objectives of the research and the type of research undertaken (Onwumere, 2005). Therefore, consistent with the above and also in line with researches conducted in this area of finance where most data utilized were obtained from the financial statements and accounts of sampled firms (Ezeoha, 2007), the nature of data for this research were of secondary nature. Secondary data are data which have been

processed, collated and exist in published form (see Onwumere, 2005). The secondary data sources used in this study were extracted from the published financial statements and accounts of the 48 quoted firms in the Nigeria Stock Exchange and also from the Annual Statement and Accounts of the Nigerian Stock Exchange. Company annual statements and reports are deemed to be reliable because they are statutorily required to be audited by a recognized auditing firm before publication (See CAMA, Section 331 – 335).

3.3 Population of the Study

Ibe, (2003) assert that it is generally known that sample statistics differs from corresponding population parameters because of chance errors of sampling. According to Ikeagwu, (1998) it is important, first and foremost to determine the group of persons or things to study. In this work, the required population comprises of all quoted manufacturing Companies in Nigerian listed in the first tier securities market and whose shares are traded on the floor of the Nigerian stock market. Ten (10) companies were randomly selected from this organized sector of the economy for this study. These companies were considered appropriate population for the study because they are statutorily required to submit their published financial statements to the Securities and Exchange Commission (SEC). Therefore financial statements published to the Nigerian Public are validated by the acceptance of such by SEC as the singular most authoritative financial medium which has consistently published financial information of Nigerian firms for over 40 years using different indices such as shares index, market capitalization, price gainers/losers, trade volume, total transactions and total deals.

3.4 Sample Size

In accordance with the Nigerian stock exchange classification of companies listed on the exchange, there were 48 companies listed on the Nigerian Stock Exchange as at December 2005 (Cashcraft, 2010). For this researches.10 firms were randomly selected each from these sub sectors;- Livestock feed plc, Dunlop plc, Guinness Breweries plc, Nigerian Wire Company plc, Cap plc, Unilever plc, Niger Flour Mills plc, Glaxo SmithKline plc, First City Aluminum plc, Avon Crown Caps and Containers plc all in manufacturing sectors, thus the sample size is 10 companies.

3.5 Sampling Technique

The sampling technique adopted in this research is the stratified random sampling method. This method involve the selection of the sample based on a classes or groups with each group or stratum having some definite characteristics or features (Onwumere, 2005; Douglas, William and Robert 2002). 10 companies was selected based on this techniques from 48 manufacturing companies in the Nigerian Stock Exchange classification of firms quoted on the exchange excluding the Banking, Insurance, Foreign listings and other Financial Servicing subsectors. The exclusion of these subsectors was based on them representing the lending end of the Nigerian financial system as well as the desire of the researcher to localize the research to Nigeria. Below is the list of the firms studied and how they are represented

TABLE 3.1**List of companies in the manufacturing sector**

INDUSTRY	COMPANIES
AGRICULTURE/AGRO AL LIED PRODUCTS	(1) Livestock Feeds Plc (2) Okomu Oil (3) Presco Plc
AUTOMOBILE AND TYRE	(4) Dunlop Plc (5) R.T .Brisco & Plc
BREWERIES	(6) Guinness (7) Nigerian Breweries Plc
BUILDING MATERIALS	(8)Asaka Cement, (9) Nigerian Wire Co.
CHEMICAL & PAINT	(10)Premier paint, (11)Berger Paint (12)CAP Plc, (13)D.N Meryer, (14)Nigerian German Chemical
CONGLOMERATES	(15) AG Leventis (16)CFAO Plc (17)UACN Plc (18) Chellarams, (19) PZ Industries, (20)Unilever Plc (21)UTC Plc
CONSTRUCTION	(22)CAPP & DAIBERTO, (23) G.CAPP (24)Julius Berger.
ENGINEERING TECHNOLOGY	(25)Nigerian Wire & Cable Plc (26)Owuka H- Tet
FOOD/ BEVERAGES & TOBACCO	(27)7-UP Plc, (28)Cadbury Plc, (29)Flour Mill, (30)Niger Flour , (31)Nestle Plc, (32)Nigeria Bottling Co. (33)P.S. Mandribs & Co., (34) Union Dacono Plc
HEALTH CARE	(35)Evans Medical, (36)Glaxo smithlime (37) Mauren Lab.(38),May

	& Baker Morision Industries. (39)Neimeth Int., (40) Pharma Deko
INDUSTRIAL/DOMESTIC	(41)Alumaco Plc, (42) S.O.C. Gas, (43) First Aluminum (44)Nigerian (45)Enamel Coy. (46)Vono Products.
PACKAGING	(47)Avon Crown Caps & Containers,(48) Beta Glass Cop.

Section B was made up of 12 items measuring various variables of the study. Four (4) of those items measured the relationship between historical cost accounts and profit of the company; Four (4) items measured the relationship between current cost accounts and the profit of the company; while Four (4) items measured the effects of taxes, deprecation and dividends on the profit of the firm.

3.6 Instrumentation

The financial statements of the companies were all evaluated on a twelve months calendar year notwithstanding the beginning and end of the financial year. The financial statements originally drawn on the historical cost basis were adjusted to current cost data using the CPI for 2001.

Questionnaire was developed to measure other key variables in the study such as historical cost and profits of the firm, the relevance of current cost accounting in period of changing prices, the effect of payment of taxes, dividends and calculation of depreciation from historical cost profit.

The instrument was developed by making phrases which are possible indicators of each of the variables. These phrases were converted to statements designed to obtain responses from the respondents.

Two-point Likert Scale was adopted for each of the questionnaire items. The options were shown as follows:

Agree - (A)

Disagree - (D)

The questionnaire was divided into sections. Section A seeks information on the personal and demographic data of the respondents.

3.7 Reliability and validity of the instruments

The financial statements used in this study were those of the companies quoted in the securities market and whose shares were traded on the floor of the Nigerian Stock Exchange. The financial statements were those submitted to the Nigerian Securities and Exchange Commission. These financial statements were accepted for publication to the Nigerian Public. These instruments were accepted as the basis for financial evaluation of the companies under study to evaluate the extent to which inflation affects the reported profits of the companies. The financial statements were further validated by the fact that these companies use them for the purpose of obtaining loans and a yardstick for evaluation of financial strengths and weaknesses by financial analysts and investment houses. Before using the converted historical financial statements and the questionnaire developed for the study, these instruments were shown to follow postgraduate students and experts in the field of accounting and auditing. Some items were screened and retained while others considered irrelevant were dropped. This was done to ensure that items were actually what they were supposed to measure. That is the reason its valid and reliable.

In the absence of published price level adjusted data, this information must be estimated. Previous studies by Peterson(1993) and Baran(1996) indicated that shortcut procedures of the restatement, as outlined by Accounting Principles Board opinion No.3, tends to produce result that do not differ significantly from those derived through detailed computations. Davidson and Weil (1995) provided a detailed description of an adjustment based upon publicly available financial statements Parker (1997) outlines in detail and adjustment procedures based upon the COMPUSTAT data which contains a more restricted set of financial data .In a recent study, Ketz (1998) suggest that the general price –level estimating models employed by the above authors are appropriate for empirical research in this area.

The method of reviving restated financial data in this study is very similar to the one used by Parker (1997) and as prescribed by the International Financial Reporting Standards (2004) and the Exposure Draft of SSAP 16.

In order to test the reliability of the research instruments, pilot study was carried out in one of the companies in the study population. The questionnaire went through a test – retest instrument reliability procedure. As a set of respondents were given a set of questionnaires to complete, and after one month the same set of respondents were given the same set of questionnaire to complete. The responses from the two sets of questionnaire were correlated with a resulting high correlation coefficient. This was considered reliable enough for this study.

The following models were employed in analyzing the data obtained for the study. Hypotheses formulated were developed in models, which were subjected to empirical tests using appropriate statistical techniques.

Pearson's Product Moment Correlation Coefficient and Chi-Square (X^2) were used in testing the hypotheses of this study.

In using Pearson's product moment correlation, the researcher is concerned with examining the extent to which two sets of variables from the same subject co-vary or are related.

Hypothesis 1:

There is no positive significant relationship between historical cost method and reported profit of manufacturing companies in Nigeria.

Pearson's product moment correlation statistic used in measuring the relationship between inflation and historical financial statement.

Variables:

Dependent-Profit of the firms

Independent-Depreciation charge

The model is given as:

$$rdp = \frac{\sum D - \frac{\sum D \sum P}{n}}{\sqrt{\left[\frac{\sum D^2 - \frac{(\sum D)^2}{n}}{n} \right] \left[\frac{\sum P^2 - \frac{(\sum P)^2}{n}}{n} \right]}}$$

Where r = the (Product Moment) Correlation of profit on the depreciation of the firm.

D = Depreciation charges of the sample firm

P = Profit made by the companies. Net profit of the companies

N = Number of companies in the sample

The combined r estimate is tested for significance using the students t-distribution

The model is given as:

$$t = \frac{\sqrt{1-r^2}}{r} = \sqrt{n-2}$$

Hypothesis 2:

Current cost method does not significantly affect the overstated profits made by manufacturing companies in Nigeria.

Chi-square (X^2) would be adopted for testing this hypothesis to ascertain the difference between the observed frequencies and the expected frequencies.

In using Chi-square, the null-hypothesis would be tested using the formula:

$$X^2 = \sum_{i=1}^k (O_i - E_i)^2 / E_i$$

Where:

The O_i = is the observed frequencies

E_i = the expected frequencies

= summation

X^2 = computed value of the chi- square

Hypothesis 3:

Current cost accounting cannot be used to remedy the inherent deficiencies in the historical cost methods. Chi square will also be used to test this hypothesis.

APPLICATION OF CHI SQUARE

A large value of X^2 would mean that there were great differences between the observed and the expected frequencies assuming the null hypothesis were true. Such differences would not be attributed to chance events arising from the sample selection therefore the null hypothesis are to be rejected. Conversely, a small X^2 value would indicate an acceptance of the null hypothesis (Levin, 1981). The chi square method is a non-parametric statistical dealing with discrete data (i.e. data that are not measured on an internal or ratio scale), and it is not possible to estimate a population such as the normal, students-T, or prison distributions. Also the chi-squared test is practically useful in analyzing data presented as in this study (kazmier, 1997). Although the X^2 statistics would not be as high a power as some other sample statistic computed from one of the parametric methods; it was found to be quite adequate for this purpose.

3.7.1 Chi –Square decision criterion for validation of hypothesis

In order to decide whether any computed X^2 value would be statistically significant to warrant the rejection of the null hypothesis, comparison would be made between each computed X^2 value of the sums number of degree of freedom from the Chi Square table .The X^2 value depends on the number of degree of freedom of the contingency table which it would be computed .The degree of freedom is defined thus:

$$df = (r-1)(c -1)$$

Where

df = degree of freedom

r = no of rows of the contingency table

c = column

Thus, the table of X^2 for the appropriate number of degrees of freedom would be compared with the computed X^2 value and level of significance based on the following decision rule:

if c.v is less than c.t (0.05), accept H_0

if c.v is greater than (0.05), reject H_0

Where,

c.v = computed value of X^2 at the 5% level of significance.

H_0 = null hypothesis

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CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Data presentation

This chapter is concerned with general description of data, statistical analysis of relevant data to each of the three hypotheses taken one after the other, presentation and statistical tests of the three hypotheses. Empirical interpretations of the three tested hypotheses are also presented. Each of the hypotheses is tested at a 0.05 level of significance.

4.2 Data description

The main data used for the empirical analysis of the study were the financial statements of the firms for 2001. A one-year period was chosen because of the volume of data to be collected for the study. The primary sources of financial statement data for the firms were from the stock Exchange commission and the financial Times. As a third source, the researcher obtained financial statements from the headquarters of some of the sample companies, the 10 financial statements required for the study were all obtained and converted to current cost data for the purpose of measuring the differential effects of the historical cost reporting method on the profit of the firms. The observed and expected frequencies of the major research variable were calculated and presented in tables 3 & 4.

Table 4.1 Observed frequencies of the major variables of historical cost overstating reported profit.

	Agreed	Disagreed	Total
Historical method does not Accommodate price changes	7	3	10
Depreciation charge using Historical cost is lower	8	2	10
The use of historical cost Overstate reported profit	8	2	10
Tax charges using historical Cost methods are high	7	3	10
Total	30	10	40

Table 4.2 Observed frequencies of the major variables of current cost reporting actual profit of the firm during price changing period

	Agreed	Disagreed	Total
Current cost method adjust key profit of Affected items before profit is declared	8	2	10
Current cost accounting is a better Alternative method of profit reporting During inflationary periods	7	3	10
Current cost method accommodates the Effects of price level changes during Inflationary period	8	2	10
Using historical cost method makes it Difficult to ascertain the actual profit made During the period of changing prices.	7	3	10
Total	30	10	40

4.3 Current Cost Adjustment Procedures

The current cost financial statements were developed from the historical cost data using the 2001 consumer price index (CPI). The current cost adjustments were made in accordance with the FASB Exposure draft and the international financial Reporting standards (IFRS) (2004) and the 1990 companies and Allied Matter Acts (CAMA).

The required adjustments were done for all the 10 companies except for the non-inventory stock service- oriented companies where adjustment for cost sales (COSA) was not carried out due to sectors affected by this COSA exception included the Banking sector, the insurance sector and the manager fund sector. The remaining three adjustments were carries out for the companies in these industries and their results analyzed based on the adjustment.

The adjustments made in this study were depreciation and accumulated depreciation adjustment, the cost sales adjustment (COSA), the monetary working capital adjustment, (MWCA), and the Gearing adjustment. Current cost profit and loss accounts and current cost balance sheets are prepared based on the adjustments made on the 10 companies sampled. Depreciation adjustment was based on the assumption that the fixed assets held by the sample companies in 2011 were acquired five years ago. Base on this assumption, assets currently held by the company were acquired in 1995. to compute depreciation adjustment for the fixed assets of the companies, the formula below was applied for all the companies.

$$\text{Depreciation} = \text{Historical cost of fixed Asset} \times \frac{\text{Index at Balance Sheet date}}{\text{index at date of purchase}} - \text{Historical cost rate}$$

The index used here is the 2001 consumers' price Index (CPI) for fixed Assets. In adjusting the cost of sales, the price index for stock (See appendix) was used. The opening stocks and closing stock were adjusted following the procedure below:

$$\text{Opening stock} \times \frac{[\text{Index at balance date}]}{\text{Index at the beginning of the year}}$$

Stocks were assumed to be acquired quarterly. That is, every three months. Therefore the closing stock were acquired in October, 2001

$$\text{Closing stock} \times \frac{[\text{Index at balance date}]}{\text{Index at date of acquisition}}$$

Purchases were assumed to occur evenly through the year.

COSA =

Current cost of opening stock	N
Add purchases	xxx
Cost of goods available for sales	<u>xxx</u>
Less: current cost closing stock	xxx
Current cost of sales	(xx)
Less historical costs of sales	(xx)
Cost of sales adjustment	(xx)
	<u>xxxx</u>

Monetary working capital adjustment represents the change in working capital due to price changes during the year. The difference between trade debtors and trade creditors represents monetary working capital. The increase/decrease in monetary working capital 2000 historical cost term. The current cost monetary working capital is obtained as follows:

(Closing MWC X [Average index

Index at balance sheet date] [opening MWC x Average index]

MWCA = Historical cost MWC – Current cost MWC

The gearing adjustment is given by gearing proportion, give as

$$\frac{\underline{L + S}}{L} \times \frac{L}{L \times S}$$

Where L = Creditors falling due after one year

S = Shareholders funds

The gearing proportion is multiplied by the sum of the other three adjustments, and the result gives the gearing adjustments.

The double entry is completed by transferring all the adjustments to the current cost reserves accounts. To obtain the value for current cost reserve, the amount for gearing adjusted from the sum of the other three adjustments. The adjusted balance sheets are prepared incorporating the four adjustments (as the cases for this study, the financial statements of the sample companies are assumed to begin January to December each year, both months inclusive. Those companies whose financial years do not begin and end by these months are considered on a twelve month calendar basis. The detailed adjustment procedure of the historical financial statement of the 10 companies is given in appendix 1

4.4 comparative presentation of historical cost financial statements and current cost financial statement

In this sector, the historical cost financial statements of the ten sampled is presented. These companies met the sampling criteria and the companies that paid dividends and taxes between 2001 and 2005 are selected for the purpose of presenting the converted

historical cost to current cost. This was done to measure the extent of the deficiency of the historical cost account on the profit of the firm and see how current cost can be used as a suitable alternative in period of changing prices.

The 10 randomly selected companies whose accounts are presented and converted in this section include:

1. Livestock feed plc
2. Dunlop plc
3. Guinness Breweries plc
4. Nigerian Wire company plc
5. Cap plc
6. Unilever plc
7. Niger Flour Mills plc
8. Glaxo SmithKline plc
9. First City Aluminum plc
10. Avon Crown Caps and Containers plc

The conversion procedure enumerated above was followed in drawing up the historical and current cost balance sheet accounts. Below are the comparisons of balance sheets of these companies.

AVON CROWN CAPS & CONTAINERS PLC

**Table 4.3 Comparison of Balance Sheet as at December 31, 2001
Reported on HC & CC Basis**

	HC	CC	% Increase /Decrease
(Diff/HC x 100)			
	# (000)	# (000)	# (000)
# (000)			
Fixed Asset	7,579,940	11,547,916	+52%
Less Accumulated Depreciation	<u>(4,421,920)</u>	<u>(6,760,967)</u>	+53%
	3,098,020	4,796,949	+55%
Current Asset	6,663,645	5,055,267	+24%Less
Current Liabilities	<u>(5,074,379)</u>	<u>(2,061,279)</u>	+59%
Net Current Asset	<u>1,589,268</u>	<u>993,98</u>	+88%
Total Asset	<u>4,687,288</u>	<u>7,790,937</u>	+66%
Financed by:			
Ordinary Share Capital	2, 500, 00	2,500,000	-
Current Cost Reserve	-	3,103,649	-
Reserve	2,187,288	2,187,288	-
Shareholder's fund	<u>4,687,288</u>	<u>7,790,937</u>	
	4,687,288	7,790,937	

Source: financial statement of Avon Crown Caps & Containers Plc (2001)

The table above shows a balance sheet of Avon Crown Caps and Containers PLC for year ended 31st December, 2001. Avon Crown Caps and containers balance sheet indicated that the value of her **Fixed Asset** as at that period shows 7,579,940 for Historical cost as against 11,547,916 for Current cost indicating 52% increase when reported on Current cost basis.

Moreover, the **Accumulated Depreciation** as that period shows (4,421,920) for Historical cost as against (6,750,967) for Current cost indicating +53% increase when reported on Current cost basis.

Total Current Asset: As that period shows 6,663,645 for Historical cost as against 5,055,267 for Current cost indicating 24% increase, when reported on Current cost basis.

Net Current Asset: For the period shows 1,589,268 for Historical cost as against 2,993,988 for Current cost indicating 88% increase when reported on Current cost basis.

Total Asset: For the period shows 4,687,288 for Historical cost as against 7,790,937 for Current cost indicating 66% increases when reported on Current cost basis. The

implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 52% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

LIVESTOCK FEED PLC

**Table 4.4 Comparison of Balance Sheet as at December 31, 2001
Reported on HC & CC Basis**

	HC	CC	% Increase /Decrease (Diff/HCx100)
	# (000)	# (000)	# (000)
Fixed Asset	535,623.	856,997	+60%
Less Accumulated Depreciation	<u>(87,426)</u>	<u>(103,083)</u>	+18%
	448,197	1753, 94	+68%
Current Asset	<u>1,078,015</u>	<u>887,216</u>	
Less Current Liabilities	<u>(868,685)</u>	<u>(142,559)</u>	+84%
Total Asset	<u>209,330</u>	<u>744,657</u>	+26%
	657,527	1,498,571	+128%
Financed By:			
Ordinary Share Capital	103,880	103,880	-
Current Cost Reserve	-	841,044	-
Reserve	469,480	469,480	-
Shareholder's fund	573,360	1,414,400	+147%
Long term Liabilities	<u>84,167</u>	<u>84,167</u>	-
	657,527	1,498,571	+28%
	<u>1,562,074</u>	<u>3,132,719</u>	

Source: financial statement of Livestock Feed plc (2001)

The table above shows a balance sheet of Livestock Feed plc for year ended 31st December, 2001.

Livestock Feed plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 535,623 for Historical cost as against 856,997 for Current cost, indicating 60% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (87,426) for Historical cost as against (103,083) for Current cost indicating 18% increase when reported on Current cost basis.

Total Current Asset: As that period shows 1,078,015 for Historical cost as against 887,216 for Current cost indicating 18% increase, when reported on Current cost basis.

Net Current Asset: For the period shows 209,330 for Historical cost as against 744,657 for Current cost indicating 26% increase when reported on Current cost basis.

Total Asset: For the period shows 657,527 Historical costs as against 1,498,571 for Current indicating 128% increase when reported on Current cost basis. The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 128% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

DUNLOP PLC

Table 4.5 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC	CC	% Increase /Decrease (Diff/HCx100)
	# (000)	# (000)	# (000)
Fixed Asset	1, 44,843.	2,011,232	+39%
Less Accumulated Depreciation	<u>(6, 10,334)</u>	<u>(513,421)</u>	+15%
	831,509	1,497,811	+80%
Current Asset	1,961,849	1,763,589	+10%
Less Current Liabilities	<u>(1,226,284)</u>	<u>(128,681)</u>	+89%
Net Current Asset	<u>735,565</u>	<u>1, 63,908</u>	+122%
Total Asset	<u>1,562,074</u>	<u>3,132,719</u>	+100%
Ordinary Share Capital	252,000	252,000	-
Current Cost Reserve	-	563,163	-
Reserve	654,164	<u>615,163</u>	+32%
Shareholder's fund	<u>906,164</u>	-	+78%
Long term Liabilities	<u>660,910</u>	<u>1,178,326</u>	-
	1,567,074	1,954,393	-
	<u>1,562,074</u>	<u>3,132,719</u>	

Source: financial statement of Dunlop plc (2001)

The table above shows a balance sheet of DUNLOP Plc for year ended 31st December, 2001.

DUNLOP Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 535,623 for Historical cost as against 856,997 for Current cost, indicating 60% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (87,426) for Historical cost as against (103,083) for Current cost indicating 18% increase when reported on Current cost basis.

Total Current Asset: As that period shows 1,078,015 for Historical cost as against 887,216 for Current cost indicating 18% increase, when reported on Current cost basis.

Net Current Asset: For the period shows 209,330 for Historical cost as against 744,657 for Current cost indicating 26% increase when reported on Current cost basis.

Total Asset: For the period shows 657,527 Historical costs as against 1,498,571 for Current indicating 128% increase when reported on Current cost basis.

The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 60% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

GUINNESS PLC

Table 4.6 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

/Decrease	HC	CC	% Increase (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	10,610,792.	15,750,304	+39%
Less Accumulated Depreciation	<u>(3,251,471)</u>	<u>(3,746,816)</u>	+15%
	7,350,320	12,003,488	+80%
Current Asset	13,496,589	110,412,966	+10%
Less Current Liabilities	<u>(8,006,234)</u>	<u>(7,675,828)</u>	+89%
Net Current Asset	<u>5,490,355</u>	<u>2,737,138</u>	+122%
Total Asset	12,828,991	14,740,626	+100%
Financed By:			
Ordinary Share Capital	353,982	353,982	-
Current Cost Reserve	-	7,416,451	-
Reserve	10,327,172	-	+32%
Shareholder's fund	10,681,154	-	+78%
Debenture stock	<u>2,177,837</u>	<u>1,178,326</u>	
	<u>12,858,991</u>	<u>14,740,626</u>	

Source: financial statement of Guinness plc (2001)

The table above shows a balance sheet of Guinness Plc for year ended 31st December, 2001.

Guinness Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 10,601,792 for Historical cost as against 15,750,304 for Current cost, indicating 48% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (3,251,471) for Historical cost as against (3,746,816) for Current cost indicating 15% increase when reported on Current cost basis.

Total Current Asset: As at that period shows 13,496,589 for Historical cost as against 10,412,966 for Current cost indicating 41% increase, when reported on Current cost basis.

Net Current Asset: For the period shows 5,490,355 for Historical cost as against 2,737,138 for Current cost indicating -50% decreases when reported on Current cost basis.

Total Asset: For the period shows 12,858,991 Historical costs as against 14,740,626 for Current indicating 14.6% increase when reported on Current cost basis.

The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 14.6% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

NIGERIAN WIRE COMPANY PLC

Table 4:7 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC /Decrease	CC	% Increase (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	4,493.	6,980	+39%
Less Accumulated Depreciation	<u>(1,745)</u>	<u>(1,212)</u>	+15%
	2,748	5,768	+80%
Current Asset	46,462	39,330	+10%
Less Current Liabilities	<u>(35,347)</u>	<u>(6,904)</u>	+89%
Net Current Asset	<u>11,115</u>	<u>32,426</u>	+122%
Total Asset	13,876	38,194	+100%
Financed By:			
Ordinary Share Capital	5,625	5,625	-
Reserve	6,683	1,568	+32%
Shareholder's fund	-	12,308	+78%
Long term Liabilities	<u>1,569</u>	<u>6,360</u>	-
Current cost reserve	-	-	
	<u>13,876</u>	<u>38,194</u>	

Source: financial statement of Nigerian Wire Company Plc (2001)

The table above shows a balance sheet of Nigerian Wire Company Plc for year ended 31st December, 2001.

Nigerian Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 4,493 for Historical cost as against 6,980 for Current cost, indicating 55% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (1,745) for Historical cost as against (1,212) for Current cost indicating 30.5% increase when reported on Current cost basis.

Total Current Asset: As that period shows 46,462 for Historical cost as against 39,330 for Current cost indicating -15% decreases, when reported on Current cost basis.

Net Current Asset: For the period shows 11,115 for Historical cost as against 32,426 for Current cost indicating 19% increase when reported on Current cost basis.

Total Asset: For the period shows 13,876 Historical costs as against 38,194 for Current indicating 18% increase when reported on Current cost base.

The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 18% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

CAP PLC

Table 4:8 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC	CC	% Increase /Decrease Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	275,179.	406,754	+39%
Less Accumulated Depreciation	<u>(95,277)</u>	<u>(91809)</u>	+15%
	179,902	314,945	+80%
Current Asset	733,538	597,066	+10%
Net Current Asset	(516,419)	(121,033)	+122%
Total Asset	<u>217,119</u>	<u>475,973</u>	+100%
	397,021	790,918	-
Financed By:			
Ordinary Share Capital	94,586	94,586	-
Current Cost Reserve	-	371,193	+32%
Other Reserve	302,435	<u>302,435</u>	-
Shareholder's fund	-	768,704	+78%
Long term Liabilities	-	-	-
	<u>397,021</u>	<u>790,918</u>	

Source: financial statement of Cap Plc (2001)

The table above shows a balance sheet of CAP Plc for year ended 31st December, 2001.

CAP Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 275,179 for Historical cost as against 406,754 for Current cost, indicating 47% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (95,277) for Historical cost as against (91,809) for Current cost indicating -4% decreases when reported on Current cost basis.

Total Current Asset: As that period shows 733,538 for Historical cost as against 597,066 for Current cost indicating 19% increase, when reported on Current cost basis.

Total Asset: For the period shows 397,021 Historical cost as against 790,918 for Current cost indicating 99% increase when reported on Current cost basis.

The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 99% but alternatively, when reported on

Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

UNILEVER PLC

Table 4:9 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

/Decrease	HC	CC	% Increase (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	3,469,204.	5,550,727	+60%
Less Accumulated Depreciation	<u>(853,981)</u>	<u>(632,502)</u>	-26%
	2,615,223	4,918,225	+88%
Investment	23,303	-	-
Current Asset	3,506,948	2,172,097	-38%
Less Current Liabilities	<u>(2,027,173)</u>	<u>(1,051,946)</u>	+8%
Net Current Asset	<u>1,479,775</u>	<u>1,120,151</u>	-24%
Total Asset	<u>4,118,301</u>	<u>6,6038,37</u>	+60%
Financed By:			
Ordinary Share Capital	605,328	605,328	-
Reserve	3,054,405	3,054,405	-
Current Cost Reserve	-	1,920,075	-
Shareholder's fund	3,659,733	5,579,808	+52%
Long term Liabilities	<u>458,568</u>	<u>458,568</u>	-
	<u>4,118,301</u>	<u>6,038,376</u>	

Source: financial statement of Unilever Plc (2001)

The table above shows a balance sheet of Unilever Plc for year ended 31st December, 2001.

Unilever Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 3,469,204 for Historical cost as against 5,550,727 for Current cost, indicating 60% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (853,981) for Historical cost as against (632,502) for Current cost indicating -26% decreases when reported on Current cost basis.

Current Asset: As that period shows 3,506,948 for Historical cost as against 2,172,097 for Current cost indicating -38% decreases, when reported on Current cost basis.

Net Current Asset: For the period shows 1,479,775 for Historical cost as against 1,120,151 for Current cost indicating -24% decreases when reported on Current cost basis.

Total Asset: For the period shows 4,118,301 Historical cost as against 6,038,376 for Current indicating 47% increase when reported on Current cost basis.

The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 47% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

NIGER FLOUR MILLS PLC

Table 4:10 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC	CC	% Increase /Decrease (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	20,107,209.	350,311,176	+16%
Less Accumulated Depreciation	-	<u>(210,178,027)</u>	-
	-	140,133,154	-
Current Asset	26,039,364	27,101,271	+4%
Less Current Liabilities	(14,000,000)	(14,000,000)	-
Net Current Liabilities	<u>12,039,364</u>	<u>13,101,211</u>	+9%
Total Asset	32,146,513	153,234,365	+38%
Financed By:			
Ordinary Share Capital	7,000,000	7,000,000	-
Current Cost Reserve	-	75,499,782	-
Other Reserve	24,494,553	710,082,623	+3%
Shareholder's fund	31,494,553	152,582,405	+12%
Long term Liabilities	<u>615,960</u>	<u>651,960</u>	+6%
	<u>32,146,513</u>	<u>153,234,365</u>	

Source: financial statement of Niger Flour Mills Plc (2001)

The table above shows a balance sheet of Niger Flour Mills Plc for year ended 31st December, 2001.

Niger Flour Mills Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 20,107,209 for Historical cost as against 350,311,176 for Current cost, indicating 16% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows 0 for Historical cost as against (210,178,027) for Current cost indicating 0% increase when reported on Current cost basis.

Current Asset: As that period shows 26,039,364 for Historical cost as against 27,101,271 for Current cost indicating 4% increase, when reported on Current cost basis.

Net Current Asset: For the period shows 12,039,364 for Historical cost as against 13,101,211 for Current cost indicating 9% increase when reported on Current cost basis.

Total Asset: For the period shows 32,146,513 Historical cost as against 153,234,365 for Current indicating 38% increase when reported on Current cost basis. The implications of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 38% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

GLAXO SMITHLINE PLC

Table 4:11 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC	CC	% Increase /Decrease (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	1,047,109	1,318,922	+26%
Less Accumulated Depreciation	<u>(453,581)</u>	<u>(382,910)</u>	-16%
	593,528	936,012	+58%
Investment	-	160	-
Current Asset	2,179,356	1,759,847	-19%
Less Current Liabilities	(1,173,969)	(1,165,904)	-0.7%
Net Current Liabilities	<u>1005,387</u>	<u>593,943</u>	- 41%
Total Asset	1,599,075	1,529,955	- 4%
Financed By:			
Ordinary Share Capital	398,626	398,626	-
Current Cost Reserve	-	400,280	-
Other Reserve	673,601	204,201	- 70%
Shareholder's fund	1,072,227	1003,107	- 6%
Long term Liabilities	<u>526,848</u>	<u>526,848</u>	
	<u>1,599,075</u>	<u>1,529,955</u>	

Source: financial statement of Glaxo Smithline Plc (2001)

The table above shows a balance sheet of Glaxo Smithline Plc for year ended 31st December, 2001.

Glaxo Smithline Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 1,047,109 for Historical cost as against 1,318,922 for Current cost, indicating 26% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (453,581) for Historical cost as against (382,910) for Current cost indicating -16% decreases when reported on Current cost basis.

Current Asset: As that period shows 2,179,356 for Historical cost as against 1,759,847 for Current cost indicating -19% decreases, when reported on Current cost basis.

Net Current Asset: For the period shows 1005,387 for Historical cost as against 593,943 for Current cost indicating -41% decreases when reported on Current cost basis.

Total Asset: For the period shows 1,599,075 Historical costs as against 1,529,955 for Current indicating -4% decreases when reported on Current cost basis. The implication of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by -4% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

FIRST ALUMINUM PLC

Table 4:12 Comparison of Balance Sheet as at December 31, 2001 Reported on HC & CC Basis

	HC	CC	% Increase /Decrease (Diff/HC x 100)
	# (000)	# (000)	# (000)
Fixed Asset	345,529	546,314	+58%
Less Accumulated Depreciation	(90,980)	(79,696)	+12%
	254,549	466,618	+83%
Investment	160	-	-
Current Asset	357,249	324,461	+9%
Less Current Liabilities	(304,407)	(10,716)	+96%
Net Current Liabilities	<u>52,842</u>	<u>313,745</u>	+49%
Total Asset	307,391	780,363	+15%
Financed By:			
Ordinary Share Capital	65,520	65,520	-
Current Cost Reserve	-	-	-
Other Reserve	241,871	472,972	-
Shareholder's fund	-	241,563	-
Long term Liabilities	-	<u>780,563</u>	-
	<u>307,391</u>	<u>780,563</u>	

Source: financial statement of First Aluminum Plc (2001)

The table above shows a balance sheet of First Aluminum Plc for year ended 31st December, 2001.

First Aluminum Plc balance sheet indicated that the value of her **Fixed Asset** as at that period shows 345,529 for Historical cost as against 546,314 for Current cost, indicating 58% increase when reported on Current cost basis.

More so, the **Accumulated Depreciation** as at that period shows (90,980) for Historical cost as against (79,696) for Current cost indicating 12% increase when reported on Current cost basis.

Current Asset: As that period shows 357,249 for Historical cost as against 324,461 for Current cost indicating 9% increase, when reported on Current cost basis.

Total Asset: For the period shows 307,391 Historical costs as against 780,363 for Current indicating 15% increases when reported on Current cost basis. The implications

of the above findings is that if balance sheet is reported on Historical Cost, the financial position will fall short by 15% but alternatively, when reported on Current cost, it will increase by the same value as shown on the table above. From the above facts, the basic problem with historical cost accounting method is that dividends, taxes and depreciation are based on profits measured by sales (which are at current values) less cost of sales and expenditure measured on historical cost values (Berliner, 1995), while Current cost accounting method has a basic principle that operating profits should only be measured and reported after the capital of the firm has been maintained (Dean, 1994).

TABLE 4.13 Livestock feed plc historical cost profit and loss account for the year 2001

	₦' 000	₦'000
Turnover		1,348,101
Gross profit	435,649	
Less operating expenses	(incl. interest 355,133)	
Profit before tax		80,516
Taxation		(21,123)
Profit after tax		59,393
Proposed dividend		(15,582)
Retained Profit transferred to reserve		<u>43,811</u>

Source: Financial statement of Livestock Feed Plc (2001)

The table above shows the historical cost profit and loss account of Livestock feed plc.

TABLE 4.14 Livestock feed plc current cost profit and loss account for the year 2001

	N' 000	N'000
Turnover		1,348,101
Trading profit before interest		89,582
Less adjustment:		
Depreciation (Additional)	25,088	
Cost of sales adjustment	91,603	
Monetary working capital	(8,917)	(107,774)
Current cost operating loss		(18,192)
Gearing Adjustment	9,955	
Loss interest paid	(9,066)	<u>889</u>
Current cost loss before tax		(17,303)
Less tax paid		(59,393)
Current cost loss after tax		(76,696)
Dividends		(15,582)
Net loss		(92,278)

Source: Financial Statement of livestock feeds PLC (2001)

The table above shows the current cost profit and loss account of Livestock feed plc.

TABLE 4.15 Dunlop plc historical cost profit and loss account for the year 2001

	₦' 000	₦'000
Turnover	721,592	3,328,459
Gross profit	669,164	
Less operating expenses		43,428
Profit before tax		(3,640)
Taxation		39,788
Dividends	
Retained profit transferred to reserve		39,788

Source: financial statement of Dunlop PLC (2001)

The table above shows the historical cost profit and loss account of Dunlop plc.

TABLE 4.16 Dunlop plc current cost profit and loss account for the year 2001

	N' 000	N'000
Turnover		3,328,459
Trading profit before interest		242,911
Less adjustment:		
Depreciation (Additional)	75,902	
Cost of sales adjustment	201,439	
Monetary working capital	(14,360)	(262,981)
Current cost operating loss		(20,070)
Gearing Adjustment	96,816	
Less interest paid	(199,483)	<u>(102,667)</u>
Current cost loss before tax		<u>(122,737)</u>
Taxation		<u>(3,640)</u>
Current cost after tax		<u>(126,377)</u>
Proposed dividends	
Totals loss for 2001		(126,377)

Source: Financial statement of Dunlop PLC (2001)

The table above shows the current cost profit and loss account of Livestock feed plc.

TABLE 4.17 Guinness plc historical cost profit and loss account for the year 2001

	₦' 000	₦'000
Turnover		14,817,218
Gross profit	7,380,273	
Less operating expenses	(2,737,022)	
Trading Profit before tax		4,643,251
Taxation		(1,548,681)
Profit after tax		3,094,570
Proposed dividends		(1,699,114)
Retained profit transferred to reserve		1,395,456

Source: financial statement of Guinness Plc (2001)

The table above shows the historical cost profit and loss account of Guinness plc.

TABLE 4.18 Guinness plc current cost profit and loss account for the year 2001

	₦' 000	₦'000
Turnover		14,817,218
Trading profit before interest		4,516,827
Less adjustment:		
Depreciation (Additional)	1288,412	
Cost of sales adjustment	614,155	
Monetary working capital	(36,201)	(1,866,366)
Current cost operating loss		(2,650,461)
Gearing Adjustment	802,537	
Less interest paid	119,806	<u>(682,731)</u>
Current cost loss before tax		1,967,730
Taxation		<u>(1,548,681)</u>
Current cost after tax		419,049
Proposed dividends		(1,699,144)
Loss transferred to general reserve		(1,280,065)

Source: Financial statement of Guinness Plc (2001)

The table above shows the current cost profit and loss account of Guinness plc.

TABLE 4.19 Nigerian wire company plc historical cost profit and loss account for the year 2001

	₦' 000	₦'000
Turnover		53,641
Gross profit		3,702
Less operating expenses		<u>(1,711)</u>
Trading Profit before tax		1,991
Taxation		(1,699,114)
Profit after tax		3,094
Proposed dividends		(1,699,114)
Retained profit transferred to reserve		N 868

Source: financial statement of Nigerian wire company PLC (2001)

The table above shows the historical cost profit and loss account of Nigerian wire company plc.

TABLE 4.20 Nigerian Wire Company Plc current cost profit and loss account for the year 2001

	N' 000	N'000
Turnover		<u>53,541</u>
Trading profit before interest		6,019
Less adjustment:		
Depreciation (Additional)	286	
Cost of sales adjustment	5,640	
Monetary working capital	(297)	(5,629)
Current cost operating loss		(390)
Gearing Adjustment	1,886	
Less interest paid	(2,317)	<u>(431)</u>
Current cost loss before tax		(41)
Taxation		<u>(1,711)</u>
Current cost after tax		(1,752)
Proposed dividends		(1,125)
Loss transferred to general reserve		(2,877)

Source: Financial statement of Nigeria wire Company PLC (2001)

The table above shows the current cost profit and loss account of Nigerian wire company plc.

TABLE 4.21 Cap Plc historical cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		118,933
Gross profit	422,555	
Operating expenses	(383,004)	
Trading profit before tax		39,551
Taxation		(17,789)
Profit after tax		21,762
Proposed dividends		(18,917)
Retained profit transferred to reserve		N2,845

Source: financial statement of Cap Plc (2001)

The table above shows the historical cost profit and loss account of Cap plc.

TABLE 4.22 Cap Plc current cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		1,118,933
Trading profit before interest		98,569
Less adjustment:		
Depreciation (Additional)	16,860	
Cost of sales adjustment	73,809	
Monetary working capital	(5,883)	(84,786)
Current cost operating loss		(13,783)
Gearing Adjustment	28,222	
Less interest paid	(59,018)	(30,769)
Current cost loss before tax		<u>(17,013)</u>
Taxation		<u>(17,789)</u>
Current cost loss after tax		(34,802)
Proposed dividends		(18,917)
Loss transferred to general reserve		(53,719)

Source: Financial Statement of Cap Plc (2001)

The table above shows the current cost profit and loss account of Cap plc.

TABLE 4.23 Unilever Plc historical cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		<u>9,365,245</u>
Gross profit	2,636,338	
Operating expenses	(2,042,292)	
Trading profit before tax		594,046
Taxation		<u>(156,193)</u>
Profit after tax		437,853
Proposed dividends		(42,730)
Retained profit transferred to reserve		N14,123

Source: Financial statement of Unilever Plc (2001)

The table above shows the historical cost profit and loss account of Unilever plc.

TABLE 4.24 Unilever Plc Current cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		<u>9,365,245</u>
Trading profit before interest		599,749
Less Adjustment:		
Depreciation(Additional)	162,138	
Cost of sales adjustment	366.435	
Monetary working capital	(73,019)	(455,554)
Current cost operating profit		144,195
Gearing Adjustment	56.841	
Less interest paid	(5,702)	(57,139)
Current cost profit before tax		(93,056)
Taxation		(156,193)
Current cost loss after tax		(63,137)
Proposed dividends		(423,730)
Loss transferred to general reserve		(486,867)

Source: Financial statement of Unilever PLC (2001)

The table above shows the current cost profit and loss account of Unilever plc.

TABLE 4.25 Niger Flour Mills Plc Current cost profit and loss account for the year 2001

	N'000	N'000
Turnover		<u>59,818,800</u>
Gross profit	18,259,830	
Operating expenses	(13,973,427)	
Trading profit before tax		4,286,403
Taxation		<u>(1,500,241)</u>
Profit after tax		2,789,162
Proposed dividends		(2,333,333)
Retained profit transferred to reserve		N452,829

Source: Financial statement of Niger Flour Mills Plc (2001)

The table above shows the historical cost profit and loss account of Niger flour Mills plc.

TABLE 4.26 Niger flour Mills current cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		59,818,800
Trading profit before interest		3,802,892
Less adjustment:		
Depreciation (Additional)	3,077,956	
Cost of sales adjustment	77,512,139	
Monetary working capital	(1,814,604)	78,77,491
Current cost operating profit		(74,972,592)
Gearing Adjustment		
Less interest paid		<u>(527,183)</u>
Loss transferred to general reserve		<u>75,499.78</u>

Source: Financial statement of Niger Flour Mills PLC (2001)

The table above shows the current cost profit and loss account of Niger flour Mills plc.

TABLE 4.27 Glaxo Smithline Plc historical cost profit and loss account for the year 2001

	₦'000	₦'000
Turnover		<u>2,504,498</u>
Gross profit	766,807	
Operating expenses	(637,899)	
Trading profit before tax		128,908
Taxation		<u>(30441)</u>
Profit after tax		98,467
Proposed dividends		(95,670)
Retained profit transferred to reserve		N2,797)

Source: Financial statement of Glaxo Smithline Plc (2001)

The table above shows the historical cost profit and loss account of Glaxo Smithline plc.

TABLE 4.28 Glaxo Smithline PLC current cost profit and loss account for the year 2001

	N'000	N'000
Turnover		<u>2,504,498</u>
Trading profit before interest		142,246
Less adjustment:		
Depreciation (additional)	53,050	
Cost of sales adjustment	158,914	
Monetary working capital	(20,452)	<u>(191,512)</u>
Current cost operating profit		(49,266)
Gearing Adjustment	2004	
Less interest paid	(13,338)	<u>(11,334)</u>
Current cost profit before tax		(60,600)
Taxation		<u>(30,441)</u>
Current cost loss after tax		(91,041)
Proposed dividends		(95,670)
Loss transferred to general reserve		<u>(186,711)</u>

Source: Financial Statement of Glaxo Smithline PLC (2001)

The table above shows the current cost profit and loss account of Glaxo Smithline plc.

TABLE 4.29 First Aluminum Plc historical cost profit and loss account for the year 2001

	N'000	N'000
Turnover		671,644
Gross profit	368,212	<u>(453,581)</u>
Operating expenses	(207,949)	
Trading profit before tax		160,263
Taxation		<u>(39,778)</u>
Profit after tax		120,485
Proposed dividends		(85,176)
Retained profit transferred to reserve		N35,309

Source: financial statement of first Aluminum Plc (2001)

The table above shows the historical cost profit and loss account of First Aluminum plc.

TABLE 4.30 First Aluminum PLC current cost profit and loss account for the year 2001

	N'000	N'000
Turnover		<u>671,644</u>
Trading profit before interest		161,064
Less adjustment:		
Depreciation (Additional)	11,950	
Cost of sales adjustment	34,431	
Monetary working capital	(4,826)	(41,561)
Current cost operating profit		(119,503)
Gearing Adjustment	15,518	
Less interest paid	(801)	(14,717)
Current cost profit before tax		(104,786)
Taxation		<u>39,778</u>
Current cost loss after tax		<u>(65,008)</u>
Proposed dividends		<u>(85,176)</u>
Loss transferred to general reserve		(20,168)

Source: Financial statement of First Aluminum Plc (2001)

The table above shows the current cost profit and loss account of First Aluminum plc.

TABLE 4.31 Avon Crown Caps and Containers PLC historical cost profit and loss account for the Year 2001

	N'000	N, 000
Turnover		<u>15,273,045</u>
Trading profit before tax		1,448,601
Taxation		<u>(681,570)</u>
Profit after tax		767,031
Proposed dividends		(500,000)
Retained profit transferred to reserve		267,031

Source: Financial statement of Avon Crown Caps and Containers Plc (2001)

The table above shows the historical cost profit and loss of Avon Crown Caps and Containers Plc.

TABLE 4.32 Avon Crown and Containers PLC current cost profit and loss account for the year 2001

	N'000	N'000
Turnover		<u>15,273,045</u>
Trading profit before interest		2,128,715
Less adjustment:		
Depreciation (Additional)	390,286	
Cost of sales adjustment	555,983	
Monetary working capital	(20,427)	(925,842)
Current cost operating profit		(1,202,873)
Gearing Adjustment	190,632	
Less interest paid	(680,114)	<u>(489,482)</u>
Current cost loss before tax		713,391
Taxation		<u>(681,570)</u>
Current cost loss after tax		(31,821)
Proposed dividends		(500,000)
Loss transferred to general reserve		<u>(468,179)</u>

Source: Financial statement of Avon Crown Caps and Containers Plc (2001)

The table above shows the current cost profit and loss account of Avon Crown Caps and Containers plc.

4.5 Results of conversion of historical cost financial statements to current cost financial statements

From the comparative financial statement of the 10 sampled companies and after converting the historical cost profit accounts to current accounts, it can clearly be seen that profits reported using current cost accounting prices, is much lower than that of the historical; and most of the companies operated at a loss unknowingly.

Livestock company reported N2.8m profit whereas it had a net loss (N22, 946.04), Niger flour Mills had a loss of (N400, 370.00) while the historical cost shows a profit of N239, 904.00 instead of N (60,600.00) Avon Crown Caps also reveals N (453,148.00) instead of N304, 010.00 profit.

Using depreciation charges which are a major variable in this study for reporting profits, it's been discovered that using historical cost accounting makes a lower depreciation to be charged against the revenue.

For Livestock Plc, historical depreciation is N43, 831.01 while current cost depreciation is N179, 870.08. Dunlop Plc. Carries historical cost depreciation of N40, 096.00 and current cost depreciation value of N50, 988.00; Niger flour Mills shows historical cost depreciation of 240,132.00 and current cost depreciation of N266, 491.00. Smith line historical cost depreciation is N382,910.00 and current cost depreciation of N453,581.00; Guinness Plc shows historical cost depreciation of N2,895.09 and current cost depreciation of N3,251.05; Nigerian Wine Company Plc. Carries historical cost depreciation of N45,116.00 and current cost depreciation of N70,919.00; Cap Plc historical cost depreciation is N644,362.00 and current cost depreciation of N1,055,017.00 , Unilever Plc historical cost depreciation is N644,362.00 and current cost depreciation of N853,981.00; First City Aluminum show historical cost depreciation of N19,930.00 and current cost depreciation of N23,956.00 while Avon Crown Caps has historical depreciation of N112,250.00 and current cost depreciation of N182,525.00. This analysis shows that the depreciation charge to the revenue using historical cost were low as compared to the method thereby making the profit to be overstated. Tax bills and dividends declared are during the period in question.

Using the historical cost profit to meet these obligations may lead to the companies touching their capital which will pose a serious threat to the service of the company.

4.6 Test of hypotheses

4.6.1 Hypothesis one

The independent variable involved in this hypothesis is the depreciation charges of the firms while the dependent variable is the net profit. In order to test this hypothesis, the historical cost depreciation of 10 companies are related to current cost profit. The two results are correlated and interpreted. Data for this hypothesis were obtained from the adjusted historical financial statements of the 10 companies.

Pearson product movement correlation analysis of the relationship between depreciation capital and net profit of the firm

	n = 10						
Variables:	$\sum C$	$\sum D$	$\sum C^2$	$\sum D^2$	$\sum C \cdot D$	$\sum C \cdot P$	r^{HC}
	$\sum p$	$\sum p$	$\sum p^2$	$\sum C \cdot p$			
Depreciation charge	3141.95	2163.90	2193834.40	1038142.93	816314.93	999500.03	0.86
Net profit	1579.54	1608.90	589332.24	550678.33			

Substantively at significant 0.05 level $T_{c8} = 2.306$ $T_{t8} = 3.41$
 $T_{c0.05} = 2.306 < T_{t0.05} = 3.41$

The result shows that there is a significant difference existing between the depreciation's charge and the profit of the firm. The null hypothesis is therefore rejected and the alternative accepted.

4.6.2 Hypothesis two

Using chi-square (χ^2) to test this hypothesis at 0.05 level of Significance, and at three (3) degree of freedom.

Since the χ^2 computed (0.52) is smaller than the critical value χ^2 of χ^2 (7.81), the null hypothesis is rejected.

It therefore means that the use of current cost method does not significantly affect the overstated profits made by these companies during period of changing prices

4.6.3 Hypothesis three

Using chi-square χ^2 to test this hypothesis at 0.05 level of Significance, and at (3) degree of freedom, the computed χ^2 (0.52) is smaller than the critical value χ^2 (7.81), the null hypothesis is rejected, indicating that current cost accounting method can make up for the deficiencies inherent in historical cost method.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses the findings of the study, examines their implication, draws conclusion and makes recommendations. The empirical verifications of the speculation that historical cost accounting method is deficient in period of prices changes and that the current cost accounting method makes up for the differences during the said period. The deficiencies of the historical cost method centre on:

- The net profit of the firm
- The value of tax charges
- The value of paid out dividend
- The value of the depreciation charges.

5.2 Differences between Historical Cost Measurement of Profit and Current cost Measurement of Profit.

The study revealed that there is a significant difference between profits measured on historical cost method and those measured on current cost method. It was learnt that during the period of changing prices, the profits measured on historical cost method are overstated because this method does not accommodate the effect of price level changes. In using this method, depreciations are charged based on old value of assets. Since the assets values are low in inflationary period the depreciation also is low. This method does not also make any room for adjustments. As such, past costs are charged against current revenue which makes the results (profits) to be unrealistic thereby presenting a high book profit from which taxes and dividends are paid to them whose values are also high.

Current cost accounting methods on the other hand, charges depreciation based on the current cost of the assets as such the profits declared are not overstated, capital maintained and values of the assets correctly stated. The uncertainty and fluctuation in the naira value in the period of changing prices make the differences in the measurement

to be very prominent. Current cost method reports profit based on the current circumstances of the firm's operations.

The study rejected the speculation that there is no relationship between historical cost accounting reporting method and the operating profit of the company during the period of changing prices; speculation that historical cost method of profit reporting during price changing period does not overstate profit. Again, it also rejected the speculation that current cost accounting method cannot report the actual profit of the firm during price changing period.

5.3 Relationship between Profit and Depreciation

Depreciation in this study attracted special attention because the value of profit made in a particular period depends on the depreciation charge since it directly increases or decreases the operating expenses while tax and dividend depend on the declared profit. Under historical cost accounting the account for the wear and tear in respect of the value of assets consumed during the period does not represent the actual value of the assets utilized. Depreciation is consequently inadequate to finance replacement. Since the depreciation value charged is in direct proportion to the asset value and during price changing period, assets are still recorded at original cost, the depreciation will also be based on the cost of the assets which eventually represent their value. The charge will be low thereby making the profit to be overstated. But using current cost method will give room for the revaluation of the assets, adjusting the cost price to current price giving the assets current values and depreciation charged on current values will be high thereby making the declared profit to be actual and realistic.

5.4 The Influence of Depreciation, Taxes and Dividend on the Profit of the Firm

This study revealed that amount calculated as depreciation, charged as taxes and paid out as dividends greatly influence the operating profit of the firm. This simply means that the method of profit measurement will greatly influence the amount charged as taxes, depreciation and dividends on the profit of the company. Since the profit reported by the company is directly related to the operating expenses of the company and since accounting basis adopted by the company directly relates to the reported profit, it

therefore follows that the amount charged as taxes, calculated as depreciation and payout as dividends directly affect the operating profit of the company.

In summary, the profit measurement method directly influence the amount calculated as depreciation, determined the amount charged as taxes and stipulate the amount paid out as dividend, from the reported profit of a given period.

5.5 The Impact of Historical Cost Method and Current Cost Method on the Profit of the Firm

In the course of this study, it was found out that the use of historical cost method have different impacts on the firm's profit from that measured on current cost method. This means that the method of measurement in use impacts differently on the profit of the firm. Historical cost method of profit measurement overstates profits and as such leaves more profit to be taxed and paid out as dividends at the detriment of the capital of the company. The current cost method of profit measurement retains more profit for further operations in the firm.

Current cost tends to present a true picture of the company's activities and of profit to be distributed to the shareholders as dividend and tax authorities as taxes.

Using historical cost method will make low depreciation to be charged thereby making huge paper profit to be reported. But current cost makes room for adjustments on the profit related items in the account to be made before net profit is declared. These adjustments make the method to be more reliable during price changing period.

5.6 Summary

This study highlighted the inadequacies of the historical cost method of accounting in reporting the profit of an organization during price changing period. It also examined the alternative reporting approaches to historical cost method of profit reporting and in particular examined the application of current cost accounting method during periods of changing prices on the profits of the firm. Necessary adjustments required to convert the historical cost accounts to current cost were examined. Functional relationships existing between the accounting methods of the study and the reported profits on one hand, and the reported profits and depreciation as one of the important variables affecting profits, on the other hand.

The deficiencies of the historical method during inflationary period and persistent rises in prices of goods and services in our economy and the incessant liquidation of businesses during this period gave rise to this study. It was necessary to carry out this to see whether businesses fail because of inflation itself or the method of accounting during inflation.

The historical cost financial statements of ten (10) manufacturing companies in Nigeria (quoted in the stock exchange market) were converted to current cost financial statements using the 2001 Consumer Price Index (CPI). Three hypotheses were raised and tested using relevant statistical techniques. Hypothesis 1 was tested using Person's product moment correlation coefficient and student's t-distribution test while Hypotheses 2 and 3 were tested using chi-square (X^2). Each hypothesis was tested for significance at 0.05 level of significance with relevant degree of freedoms to the statistical techniques employed. From the results, all of the null hypotheses were rejected and their corresponding alternatives retained.

Findings

The findings showed that there is a positive relationship between historical cost method and the reported profits of companies in Nigeria during period of changing prices. The study showed that current cost method significantly affects the overstated profits made by these companies during period of changing prices. The study also revealed that Using depreciation charge and net profit after tax are not current cost accounting method to be used to remedy the seeming deficiencies inherent in the historical cost method current cost method can report the actual profit of the firm during price changing period .

5.7 Conclusion/discussion of results

Based on the findings of this study, it was concluded that there is a positive relationship between the historical cost method and the operating profit of the firm.

That the historical cost method of accounting during price changing period overstates the profits;

- That current cost method of profit reporting can report the actual profit of the company during price changing period.
- That asset values are understated using historical costing.

- Those adjustments are necessary on the key profit variables to reflect the price level changes before profits are declared.
- Using historical cost method of profit reporting charges low depreciation and allows large amount to be available for taxes and dividend.
- Current cost method is based on the current operations of the firm.
- It was also concluded that, Inflation itself does not lead to liquidation of the firms but the method of accounting for the inflation as the historical cost method does not present the true position of the company during inflationary period.

5.8 Recommendations

In order to restore confidence on the organizational financial reports during inflationary period and for the sake of the going concern of Nigerian businesses and using the findings of this study, the following recommendations are deemed necessary:

1. Since inflation has made historical cost method of accounting to be inadequate, transactions and accounts should be made inflation compliant to ensure that profits reported from such transactions are not misleading. The historical financial statements should be published together with current cost financial statements to lay bare before the investors and shareholder the effects of inflation on the company's financial transactions. The Securities and Exchange Commission of Nigeria should make current cost statements a precondition for filing annual returns in the commission. The submission of accounts and financial statements adjusted for effects of price changes should be made on of the conditions for firms to be listed in the stock market. This action will fairly protect the interest of investors especially in periods of rapid price changes.
2. The differences in profits measured on historical cost method and those measured on current cost method impact the going concern of the firm differently. The historical cost method overstates the reported profit of the firm, it is hereby recommended that during the period of changing prices, the assets of the firms should be revalued to reflect the price level changes before depreciation is

- calculated and charged to the accounts. This will give a high depreciation charge and high depreciation charge means low profit and vice versa.
3. Necessary adjustments should be carried out on the historical cost account to reflect current values before profits are declared upon which taxes will be charged and dividends paid.
 4. Accounting bodies in Nigeria should organize workshops for the accountants and managers of companies to create enough awareness on current cost accounting and the need to depart from the historical cost accounting method during inflationary period.
 5. The application of current cost method of profits reporting is highly recommended to Nigerian companies during price changing period as it is the only alternative that can make up for the deficiencies of historical cost method as revealed in this study.

5.9 Suggestions for Further Research in the Study

Those who are interested in conducting researches on deficiencies in the historical cost accounting on the reported profits of a company and the remedial effects of the current cost account should go beyond the scope of this study which was limited by a number of factors ranging from economic, time, statistical techniques and lack of data. The sample size of this study was limited to 10 companies in the first tier stock market due to time and funds. Further researchers should go beyond this sample size and into the second tier security market in order to cover some characteristics not covered in this study.

Future researchers should also induce resource allocation and investment from the current cost.

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APPENDIX II
QUESTIONNAIRE

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THE EFFECT OF HISTORICAL COST ACCOUNTING ON THE REPORTED PROFIT OF A COMPANY: AN EVALUATION OF CURRENT COST ACCOUNTING AS AN ALTERNATIVE REPORTING METHOD DURING PERIOD OF CHANGING PRICES

Dear Respondent,

I am conducting a research on the Effect of Historical Cost Accounting on the reported profit of a company: An evaluation of Current Cost Accounting as an alternative reporting method during period of changing price on Nigerian quoted companies. You are please requested to respond to every item in this questionnaire by placing (/) in the appropriate column or box to indicate your view on how deficient historical cost accounting is on the profit of the company during inflationary period.

The questionnaire contains two sections (i.e. A and B). Section A requires information on personal and demographic data; section B is concerned with information on the deficient nature of historical cost on organizational profit and how Current Cost Accounting can make up for the deficiencies during the period of price changes.

The information on this questionnaire is mainly for this research and no more else.

Confidentiality is hereby guaranteed.

Your organization-----

1) Age 31- 40 years (); 41-45 years (); 51 and above ()

2) Educational qualification:

NCE/OND () HND, B. SC, () MSC AND ABOVE ()

3) Number of years worked with the company-----

1	Companies in Nigeria generally use historical cost accounting in reporting profits.	Agree	Disagree
2	Historical cost method does not accommodate price changes.		
3	Historical cost profit differs from the current cost profit during period of changing prices.		
4	Depreciation charge using historical cost during price changing is low but high using current cost method.		
5	The use of historical cost overstates profits during price changing period.		
6	Current cost method enables key profit affected items to be adjusted in the account to reflect price changes before profit is declare.		
7	There id need for alternative method of reporting to historical method during the period of changing prices.		
8	Current cost accounting is a better alternative method of reporting during inflationary period.		
9	Current cost method accounting dates the effect of price level changes during inflationary period		
10	Tax charges using historical method of profit reporting ate high during price changing period.		
11	Dividend payments are higher using historical method during price changing period.		
12	Using historical cost method makes it difficult to ascertain the actual profit made during the period of changing prices.		

APPENDIX III**PLANT & MACHINERY INDEX**

1995	-	250
1969	-	330
1997	-	170
1998	-	160
1999	-	270
2000	-	340
2001	-	160

APPENDIX IV

Nigeria – Monthly inflation rate: 1991 – 2003 (Reviewed may 2003)

Month/year 2001

Base year

Jan	-	8.6
Feb	-	10.3
March	-	11.9
April	-	13.9
May	-	
June	-	
July		
August		
Sept.	-	8.4
Oct	-	18.6
Oct.	-	18.6
Nov.	-	18.7
Dec.	-	18.9

Source: CBN Statistical Bulletin 2005