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Impact of inflation and economic crises on financial reporting standards: A case study of Nigeria Economy

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Abstract

The study investigated the Impact of Inflation and Economic Crises on Financial Reporting Standards; A case Study of Nigeria Economy. The study employed ex-post-facto research design and secondary data were sourced from statistical bulletin etc. the data collected were analyzed using multiple linear regression. From the data analysis, the result showed that interest rate has a strong positive effect, indicating that it improves companies financial metrics and affect inflation rate. It also indicated that exchange rate also has positive effect on inflation and as well improve companies performance. however, consumers price index has negative pressure on company financial performance. it is based on this result that the study recommended that companies should consider a diversified risk management strategy to mitigate the uncertain impact of macroeconomic fluctuations.

Keywords: Inflation; Economic Crises; Financial Reporting Standard; Nigeria Economy

1. Introduction

Inflation and economic crises have long been pivotal factors influencing the global financial landscape. Inflation, defined as the general increase in prices and the consequent decline in purchasing power, can significantly distort the valuation of assets and liabilities, leading to financial statements that may not accurately reflect an entity's economic reality. Economic crises, characterized by severe disruptions in financial markets and economic activities, further complicate financial reporting by introducing volatility and uncertainty. These phenomena pose substantial challenges to the application and integrity of financial reporting standards, which are designed to provide consistent and comparable information to stakeholders. The historical context underscores the profound impact of these economic conditions on financial reporting. For instance, during the hyperinflationary period in Zimbabwe, traditional historical cost accounting methods failed to capture the real value of transactions, leading to misleading financial information (Chamisa et al., 2018). Similarly, the global financial crisis of 2007–2008 exposed significant weaknesses in existing financial reporting frameworks, as many financial instruments were not adequately valued, resulting in a loss of stakeholder confidence (Laux & Leuz, 2010).

In recent years, the resurgence of inflationary pressures and economic uncertainties, exacerbated by events such as the COVID-19 pandemic and geopolitical tensions, have reignited concerns regarding the adequacy of current financial reporting standards. The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have undertaken initiatives to address these challenges, emphasizing the need for more robust frameworks that can withstand economic volatilities (IASB, 2021).

Despite these efforts, significant gaps remain in understanding the comprehensive impact of inflation and economic crises on financial reporting standards. Existing literature has primarily focused on isolated aspects, such as the effects of inflation on asset valuation or the implications of economic downturns on specific industries. Moreover, this research

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is timely, given the current global economic environment characterized by rising inflation rates and recurring economic disruptions. As businesses and economies navigate these challenges, a nuanced understanding of their implications on financial reporting standards becomes imperative. This necessitated this study into investigating the Impact of Inflation and Economic Crises on Financial Reporting Standards

1.1. Statement of the problem

Inflation and economic crises significantly impact financial reporting standards, distorting asset valuations, revenue recognition, and financial disclosures. Despite the existence of IFRS and GAAP, these frameworks struggle to address the financial distortions caused by persistent inflation and economic downturns. While some standards, such as IAS 29, exist for hyperinflationary economies, gaps remain in addressing moderate inflation and financial uncertainty during crises. However, most research lacks empirical studies on how inflation and economic crises affect the reliability and comparability of financial reports. This study therefore aims at addressing this critical gap by examining how inflation and economic crises influence the reliability, relevance, and comparability of financial reports under prevailing financial reporting frameworks. Addressing this issue is crucial for investors, regulators, and policymakers, as ineffective financial reporting during economic crises can lead to misinformed investment decisions, regulatory inefficiencies, and weakened financial stability. Conversely, failing to address this problem may further erode investor confidence and hinder economic recovery efforts in the face of continued economic uncertainty. This therefore, necessitated that this study investigates impact of inflation and Economic Crises on Financial Reporting Standards

Aim/ Objectives of the study

The major aim of the study is to investigate the impact of Inflation and Economic Crises on Financial Reporting Standards. Specifically, the objective of the study will focus on

- The effect of Consumer Price Index (CPI) on earning quality the impact of Exchange Rate Fluctuations on earning quality.
- The effect of Interest Rate Trends on earning quality

2. Literature Review

2.1. Conceptual framework

2.1.1. Theoretical studies

The effect of Consumer Price Index (CPI) on earning quality

The Consumer Price Index (CPI) serves as a critical economic indicator, reflecting the average change over time in the prices paid by consumers for goods and services. Earnings quality, on the other hand, pertains to the degree to which reported income provides accurate information about a firm's true financial performance, often emphasizing the sustainability and reliability of earnings (Nissim, 2022). Understanding the interplay between CPI fluctuations and earnings quality is essential, as inflationary trends can influence corporate financial reporting and the integrity of earnings. The relationship between macroeconomic variables, such as inflation, and earnings quality has garnered attention in academic research. Studies have explored how inflation impacts financial reporting, potentially leading to earnings management practices. For instance, Nissim (2022) provides a comprehensive analysis of earnings quality, discussing various factors that can affect the reliability and sustainability of reported earnings Additionally, research has examined the role of political connections in financial reporting. Zahid and Ahmed (2023) investigate how political affiliations of board members can affect earnings quality and firm performance. Their findings suggest that politically connected firms may exhibit lower earnings quality, as these connections can lead to earnings manipulations to present a more favorable financial position. Although this study does not directly address CPI, it highlights external factors that can influence earnings quality.

Nissim (2022) employs a thorough review of earnings quality issues, analyzing both financial and non-financial indicators to assess the sustainability and reliability of earnings. His work emphasizes the importance of understanding various factors, including economic conditions, that can affect earnings quality. Zahid and Ahmed (2023) utilize a sample of 114 non-financial firms listed on the Pakistan Stock Exchange over a ten-year period, applying Generalized Method of Moments (GMM) estimates for panel data to examine the interaction between political connections and earnings quality.

The existing literature indicates that external economic factors, such as inflation measured by the CPI, can have significant implications for earnings quality. While direct studies linking CPI fluctuations to earnings quality are limited, the broader research on economic conditions and financial reporting suggests a potential relationship. For example, inflation can erode the real value of reported earnings, prompting firms to engage in earnings management to meet investor expectations. Nissim (2022) discusses how various economic factors can impact earnings sustainability, indirectly highlighting the relevance of CPI movements. Moreover, external influences like political connections can exacerbate issues related to earnings quality. Zahid and Ahmed (2023) find that firms with political affiliations are more prone to earnings manipulations, suggesting that external pressures can compromise the integrity of financial reporting.

Impact of Exchange Rate Fluctuations on earning quality

Exchange rate fluctuations have long been a subject of interest in financial and economic research due to their potential impact on corporate profitability and earnings quality. Several studies have investigated the relationship between exchange rate fluctuations and corporate earnings. Study by Astuti and Setiyawati (2023) examined the effect of exchange rate differences and inventory turnover on profit quality and their impact on firm value during the COVID-19 pandemic. Their findings indicated that exchange rate differences had a significant positive effect on earnings quality during the pandemic, suggesting that companies benefited from favorable exchange rate movements during this period. In another study, the impact of exchange rate fluctuations on corporate profits was reviewed, highlighting the risks associated with international activities of companies. The study emphasized the importance of forecasting exchange rates to mitigate potential losses from unfavorable currency movements.

Astuti and Setiyawati (2023) further utilized regression analysis to assess the relationship between exchange rate differences and earnings quality, controlling for variables such as inventory turnover. Their study also concluded that effective management of exchange rate differences and inventory turnover positively influenced profit quality, which in turn enhanced firm value during the COVID-19 pandemic.

The review on the impact of exchange rate fluctuations on corporate profits underscored the necessity for companies to adopt both traditional and modern forecasting techniques to predict exchange rate movements. This proactive approach can help firms reduce potential losses from adverse currency fluctuations. A common theme across these studies is the recognition of exchange rate fluctuations as a significant factor influencing earnings quality. The positive relationship identified between favorable exchange rate movements and improved earnings quality suggests that companies can benefit from currency appreciation. However, this relationship may not hold in cases of currency depreciation, indicating a potential asymmetry in the impact of exchange rate movements on earnings quality. Additionally, the emphasis on forecasting and managing exchange rate risks highlights a trend towards proactive financial management in mitigating the adverse effects of currency volatility. This underscores the importance of robust risk management practices in maintaining earnings quality amidst exchange rate fluctuations.

The effect of Interest Rate Trends on earning quality

The interplay between interest rate fluctuations and earnings quality has been a focal point in recent financial research. Scholars like Nissim (2022) provides an extensive review of earnings quality issues, aiming to deepen the understanding of earnings quality and facilitate the development of comprehensive indicators and analyses. his work shows the complexity of defining and measuring earnings quality, highlighting the need for contextual and granular approaches. Fonou Dombeu and Nomlala (2023) also offer an overview of earnings quality research. Their study showed the impact of fair value accounting on earnings quality and the models used to measure accrual quality, providing insights into how these factors influence financial reporting. In a study focusing on the Iraqi financial sector, Salmanbeik and Jamil (2023) analyzed how fluctuations in interest rates impact profit quality metrics. Utilizing correlation, regression, and panel data analysis over a decade, they find that interest rate changes significantly affect earnings quality, suggesting that monetary policy shifts can influence financial reporting practices. Salmanbeik and Jamil (2023) utilize quantitative methods, including correlation and regression analyses, to examine the relationship between interest rate fluctuations and profit quality in Iraq's financial sector. Their decade-long panel data analysis offers empirical evidence of the significant impact of interest rate changes on earnings quality.

Studies has also highlighted that fluctuations in interest rates can lead to changes in corporate financial behaviors, such as adjustments in investment strategies and financial reporting practices. However, there is variability in findings regarding the direction and magnitude of these effects, suggesting that contextual factors, such as regional economic conditions and industry-specific characteristics, play a crucial role. While these studies contribute valuable insights, certain limitations persist. Nissim's (2022) comprehensive review offers a solid foundation but may benefit from empirical validation to support theoretical assertions. The work of Fonou Dombeu and Nomlala (2023) identifies critical areas for future research but acknowledges that the effectiveness of models separating earnings quality components

remains unclear. Therefore, Understanding the effect of interest rate trends on earnings quality is vital for stakeholders, including investors, regulators, and policymakers.

2.2. Theoretical Framework

The study is anchored on Positive Accounting Theory (PAT), developed by Ross L. Watts and Jerold L. Zimmerman in 1978. This theory states that accounting practices are chosen by firms and managers based on economic incentives rather than purely normative or theoretical principles. The theory argues that managers select accounting policies that maximize their own utility, considering factors such as compensation structures, debt contracts, taxation, and political costs. Ther use of the theory in this is significant in that the theory provides a realistic, empirical, and predictive framework for understanding how managers and firms respond to economic fluctuations through accounting choices.

3. Methodology

3.1. Research Design

This study employs an ex-post-facto research design to investigate the impact of inflation and economic crises on financial reporting standards. Given the retrospective nature of this design, secondary data sources are integral to the research.

3.2. Study Area

The study was conducted in Nigeria and Dangote cement and BUA cement was used as a case study

3.3. Sources of Data

Secondary data were sourced from reputable government databases, such as the International Monetary Fund (IMF), economic data from central banks, financial institutions, and government agencies, statistical bulletin and the World Bank, which provide comprehensive economic indicators, including inflation rates and economic performance metrics. Additionally, financial reports from publicly traded companies, accessible through platforms like the U.S. Securities and Exchange Commission's EDGAR database, will be utilized to examine financial reporting practices. Peer-reviewed academic journals were also be consulted to gather insights into previous studies on the subject.

The reliability of these sources is well-established in the literature. Yin (2018) emphasizes that government databases and official financial reports are credible due to their standardized data collection and reporting procedures. To ensure accuracy and consistency in data extraction, a systematic approach was adopted. Data was collected for a defined period, 10years(2015 -2024) ensuring temporal alignment across all variables. Each dataset was be cross-verified with multiple sources to confirm its validity, and discrepancies was addressed through triangulation methods.

3.4. Codification of Research Variables

In alignment with the research objectives, the study focus on the following variables:

- Independent Variables: Inflation rates and indicators of economic crises (e.g., GDP contraction, unemployment rates).
- Dependent Variable: interest rate, exchange rate and consumer price index(CPI).

Model Specification

To analyze the relationships between the variables, an econometric model was specified as follows

$$IFR=\beta0+\beta1\times CPI+\beta2\times ER+\beta3\times IR+\epsilon i \ldots\ldots\ldots\ldots\ldots\ldots 1$$

Where,

- IFR = inflation rate
- CPI = Consumer price index
- ER= exchange Rate
- IR=interest Rate
- β0- β3 = constant
- ϵi=error term

3.5. Validity and Reliability

To ensure the validity and reliability of secondary data collected, financial reports collected were cross-verified with regulatory filings and independent audit reports as outlined by (Yin, 2018). Data triangulation was also applied by comparing multiple sources to mitigate bias.

3.6. Data Analysis

Statistical techniques such as regression analysis was used to determine the relationship between inflation, economic crises, and financial reporting changes, using Sigma plot version 12 software.

4. Result

Table 1 Regression Result of financial metrics of BUA Cement

Variables	Coefficient	Std. Error	t	P
Constant	0-1.915	3.229	-0.593	0.572
CPI	-0.00407	0.0109	-0.374	0.720
ER	0.0215	0.0116	1.860	0.105
IR	0.759	0.342	2.221	0.062

IFR = -1.915 - (0.00407 * CPI) + (0.0215 * ER) + (0.759 * IR) ; N = 11 ; R = 0.964 Rsqr = 0.930 Adj Rsqr = 0.900; Standard Error of Estimate = 2.576

Table 1 depicts regression analysis for the financial metrics of BUA Cement reveals key relationships among macroeconomic indicators and their influence on financial performance.

The coefficient of CPI is -0.00407, meaning that for every one-unit increase in CPI, the financial metric is expected to decrease by 0.00407, holding other factors constant. The negative sign implies that rising consumer prices negatively impact BUA Cement's financial performance. However, the associated standard error of 0.0109, t-value of -0.374, and P-value of 0.720 suggest that this effect is statistically insignificant. This result indicates that fluctuations in the CPI do not have a significant direct impact on the financial metric within the observed period.

However, exchange rate variable has a coefficient of 0.0215, suggesting that a one-unit increase in the exchange rate(ER) has 0.0215(21%) increase in the financial metric. This positive coefficient indicates that as the Naira depreciates against foreign currencies, BUA Cement's financial performance improves, likely due to increased exports or pricing adjustments. However, the standard error of 0.0116, t-value of 1.860, and P-value of 0.105 indicate that while this relationship is moderately strong, it does not reach conventional statistical significance. This suggests that exchange rate fluctuations influence financial performance but are not the primarily determinant.

The coefficient of the interest rate(IR) is 0.759(75%), indicating that a one-unit increase in the interest rate results in a 0.759(75%) increase in the financial metric. This is the strongest positive relationship among the independent variables, suggesting that higher interest rates may be associated with improved financial performance, possibly due to strategic financial management in response to borrowing costs or investment returns. The standard error of 0.342, t-value of 2.221, and P-value of 0.062 indicate a near-significant impact, suggesting that interest rate changes play a substantial role in BUA Cement's financial metrics, though it remains just outside the conventional 5% significance threshold.

The R-squared value of 0.930 implies that 93.0% of the variation in the financial metric is explained by CPI, ER, and IR, demonstrating a robust model. The adjusted R-squared of 0.900 accounts for the number of predictors and still indicates that 90.0% of the variability in financial performance is captured, confirming the model's strong explanatory power.The standard error of the estimate is 2.576, indicating the average deviation of observed values from the predicted values. While this suggests some variability, the high R-squared value compensates for it, reinforcing the model's reliability in explaining financial performance trends in BUA Cement. Overall, while the regression model is strong, the statistical significance of individual predictors varies, with interest rates showing the most substantial influence, exchange rates displaying moderate impact, and CPI appearing to have minimal effect.

Table 2 indicated that the coefficient for CPI is -0.0259(-25%), indicating that a one-unit increase in CPI leads to a 0.0259(-25%) decrease in the financial metric, holding other factors constant. The negative coefficient suggests that

rising consumer prices negatively impact Dangote Cement's financial performance. However, the standard error of 0.0368, a t-value of -0.705, and a P-value of 0.504 show that this effect is not statistically significant.

Table 2 Regression Result of financial metrics of Dangote Cement

Variables	Coefficient	Std. Error	t	P
Constant	0-1.915	12.575	-0.530	0.612
CPI	-0.00259	0.0368	-0.705	0.504
ER	0.0281	0.0360	0.780	0.461
IR	1.404	0.906	1.550	0.165

IFR = -6.668 - (0.0259 * CPI) + (0.0281 * ER) + (1.404 * IR) ; N = 11 ; R = 0.685; Rsqr = 0.469 Adj Rsqr = 0.241; Standard Error of Estimate = 8.104

The exchange rate variable has a coefficient of 0.0281(28%), meaning that a one-unit increase in the exchange rate results in a 0.0281(28%) increase in the financial metric. This suggests that as the exchange rate increases, Dangote Cement's financial performance improves, likely due to export advantages or pricing strategies. However, the standard error of 0.0360, a t-value of 0.780, and a P-value of 0.461 indicate that this effect is not statistically significant. The interest rate has the highest coefficient, at 1.404, indicating that a one-unit increase in the interest rate leads to a 1.404 increase in the financial metric, making it the most influential predictor among the independent variables. This suggests that fluctuations in interest rates significantly impact Dangote Cement's financial performance, possibly through borrowing costs and investment returns. However, the standard error of 0.906, a t-value of 1.550, and a P-value of 0.165 indicate that while this variable has a stronger effect than CPI and ER, it still lacks statistical significance at conventional levels.

The correlation coefficient (R = 0.685) suggests a moderate relationship between the independent variables and the financial metric. The R-squared value of 0.469 indicates that 46.9% of the variation in the financial metric is explained by CPI, ER, and IR, showing a moderate level of explanatory power.

5. Conclusion

Finding showed that a moderate relationship between macroeconomic variables—Consumer Price Index (CPI), Exchange Rate (ER), and Interest Rate (IR)—and the company's financial performance. Among the three variables, the interest rate (IR) has the strongest positive influence, with a coefficient of 1.404, indicating that increases in interest rates tend to improve the company's financial metric. The exchange rate (ER) also exhibits a positive relationship (0.0281) with financial performance, implying that currency depreciation could have a favorable impact on the company's operations, possibly due to export advantages or adjusted pricing strategies. CPI shows a negative effect (-0.0259), indicating that inflationary pressures could harm the company's financial performance.

The high multicollinearity associated with CPI further suggests that inflation may be indirectly influencing financial performance through other economic variables. Therefore, it is recommended that companies should consider a diversified risk management strategy to mitigate the uncertain impact of macroeconomic fluctuations.

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