

AN EVALUATION OF THE TRADITIONAL HISTORICAL COST BASIS OF ACCOUNTING IN PROVIDING VALUE AND RELEVANCE OF ACCOUNTING INFORMATION RELEVANT FOR DECISION MAKING TO THE STAKEHOLDERS IN THE NEW ECONOMY FIRMS

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ABSTRACT

This study is an evaluation of the traditional historical cost basis of accounting in providing value relevance of accounting information relevant for decision making. a case for TelOne (Pvt) Ltd; Econet Wireless Zimbabwe Limited and Telecel Zimbabwe Limited. The main research question was, what are the strengths and weaknesses of the traditional historical cost basis of accounting in providing value relevance of accounting information relevant for decision making in the Telecommunication sector? Mixed approach was used in the study. The study sample size was 100 participants drawn from a population of 600. The questionnaire was used to collect data. The major finding was that, historic cost accounting has some noticeable weaknesses of failing to adequately disclose intellectual capital causing it to be viewed as a method that provide inadequate information to stakeholders to enable them to make informed business decisions. The study recommended, fair value accounting method which recognizes intangible assets hence enhance value relevance of accounting information to users.

KEY TERMS

New economy firms, historical cost basis of accounting, value relevance.

1. INTRODUCTION/BACKGROUND OF THE STUDY

Despite the almost universal adoption of International Financial Accounting Standards (IFRS) by accounting regulatory committees in many countries, the Fair Value continues to foster an intense debate about its impact on the recent global financial and economic crisis. This debate is part of a broader one on the risks and opportunities that the financial and economic crisis has for accounting. Between 2008 and 2012, much research had attempted to study how the recent crisis has affected theory and practice in accounting. In this context, most of the controversy of accounting focuses on the comparison between two alternative approaches to accounting: the approach based on the principle of fair value and the approach based on the prudence, especially historical cost principles.

More specifically, the introduction of International Financial Reporting Standards (IFRS) by the International Accounting Standard Board (IASB) has led to the change of accounting measurements, from the Historical Cost Accounting to the Fair Value Accounting. Effectively, even before the 2008/09 Global financial crisis there was a series of critical studies about the IFRS arising especially from the European continental doctrine where standard setters warned against the dangers of the use of fair value measurements in financial reporting. Capron (2005) also hinted that, when the assets are accounted for at fair value, the values of financial statement of the firms are influenced by change of their market prices over time. He highlights that these measurements can lead to adulterate and to misinterpret the asset values.

Rodriguez-Perez et al, (2011) allude that, Fair Value Accounting versus Historical Cost Accounting mainly revolves around the traditional divergence between relevance, namely the utility of information accounting for the different users, and reliability, namely the accuracy of information. Rodriguez-Perez et al (2011) further corroborate their assertion on fair value by indicating that, it provides more relevant information to investors and creditors than historical cost. However, they also considered historical cost more objective and reliable than fair value.

In other words, the global financial crisis shows the criticality of trade-off between relevance and reliability of accounting information in markets that are above all imperfect and incomplete. Indeed, one of the key lessons of the Global financial crisis is therefore the gap between market value and real value of assets and liabilities appearing on the financial statements of the firms. Bignon et al, (2009) argue that the usage of Fair Value Accounting is limited by asymmetries of information, complementarities and specificities. Bignon et al (2009), further allude that, the evaluations based on fair value can compromise the reliability of accounts and introduce the risk of incorporating financial volatility into the accounts. Fair Value Accounting may not guarantee correct information to all the stakeholders. These Authors conclude that in presence of asymmetries of information, complementarities and specificities is preferable to opt for the historical cost (Bignon et al., 2009).

It appears in the views of Bignon et al (2009), that, a Fair Value view seems to underpin on logic and coherent theoretical foundations while the alternative view arising from a pragmatic approach to specific issues seems to lack theoretical basis. The Fair Value view cannot be a so attractive and good theory as it is not related to the real world. On the other hand, the historical cost accounting view, even if characterized by a high specificity, finds theoretical support in the works of Hicks, Edwards and Bell, Beaver and Demski (2011).

1.1 Statement of the Problem

Underlying the fact that the Telecommunication industry assets are intangible since they rely strongly on intellectual capital, to succeed and build competitive advantage, the historical accounting basis which is largely used in the industry is questionable to recognize and measure these intangibles adequately. This study seeks to evaluate the traditional historical cost basis of accounting in providing value and relevance of accounting information relevant for decision making to the stakeholders in the new economy firms.

1.2 Objective

To evaluate the strengths and weaknesses of the traditional historical cost basis of accounting in providing value and relevance of accounting information relevant for decision making to the stakeholders in the Telecommunication sector of the economy.

1.3 Assumption of the Study

The assumptions underlying this study are as follows:

- Traditional historical cost basis of accounting provides value and relevance accounting information for decision making purposes by stakeholders in the new economy firms.
- Traditional historical cost basis of accounting does not provide value and relevance accounting information for decision making purposes by stakeholders in the new economy firms.
- The researcher will be supplied with true and accurate data to inform the study.

1.4 Limitations of the Study

The fundamental limitations of this study are as follows:

- **Limited scope**

The scope of this study is limited to an evaluation of the traditional historical cost basis of accounting in providing value and relevance of accounting information relevant for decision making to the stakeholders at TelOne Econet and Telecel in relation IFRS within Zimbabwe's Telecommunications Industry rather than all corporates listed or not listed on the Zimbabwe Stock Exchange which have similar problems in presenting value relevance accounting information. The broadness of the field of value relevance of accounting information relative to IFRS and the broadness of companies that report using historical accounting basis of accounting in valuing their assets, offers the risk that the researcher may omit key concepts that otherwise enhance the validity of the study. However, these problems can only be mitigated when the study recommends for future studies to include all company's public and private in Zimbabwe.

- **Confidentiality of information**

The unavailability of secondary data due to its confidentiality nature was a threat to the study results' credibility. The researcher sought to address the problem of confidentiality of certain information by engaging responsible directors and management of TelOne, Econet and Telecel Zimbabwe seeking authority to conduct the study in their respective companies, explaining the benefits the organizations would obtain when the study is concluded. This created good rapport and trust between the researcher and the companies resulting in them releasing information which relevant to the study.

- **Accounting knowledge and skills limitations**

The knowledge and accounting skills of company directors particularly audit committees and knowledge gaps of internal and external auditors on application of IFRS within the Telecommunication industry present a problem as the study would seek to get expert knowledge on the adoption and implementation of accounting basis for value relevance of accounting information in financial statements presented by management to users of accounting information for them to make informed business and investment decisions.

2. LITERATURE REVIEW

IFRS was introduced to increase the international comparability of financial statements. Following the introduction of this new accounting regime, numerous studies have been conducted in different accounting regulatory settings that examine the impact of IFRS on accounting information quality so as to ensure value relevance of accounting information to users of the information for a variety of purposes. These studies generally examine the effect of the change on accounting information value relevance and report mixed findings.

In Greece, studies conducted by Karampinis and Hevas, (2009); Iatridis and Rouvolis, (2010) and in France studies carried-out by Cormier, Demaria, Lapointe-Antunes and Teller, (2009) provide evidence that IFRS adoption leads to higher quality of financial statements as reflected in the more value relevant accounting measures. Taylor (2009), on the other hand, finds no support to conclude that financial statements prepared under IFRSs in the U.K., Hong Kong and Singapore are incrementally value relevant to financial statements prepared under the Traditional Accounting Standards (GAAP), while Mohd Halim, Rozainun and Muhd-Kamil (2009) report improved value relevance for book value but not earnings in Malaysia.

Nonetheless, limited studies have been conducted to examine the effect of IFRS in the context of the value relevance of intangible assets. Morricone, Oriani and Sobrero (2009) for example, investigate whether and to what extent the implementation of IFRS affects the value relevance of intangible assets using a sample of Italian publicly listed firms. Using the Ohlson (1995) model, they examine both the incremental and relative value relevance of intangible assets following the mandatory adoption of IFRS. Findings from these studies show that goodwill and identifiable intangible assets are value relevant under both Italian GAAP and IFRS. However, Italian firms experienced a statistically significant decrease in the value relevance of intangible assets, particularly goodwill, after the introduction of the new accounting standard. They argue that IFRS recognition criteria that require the impairment test of goodwill and the subsequent higher discretion in goodwill valuation may provide investors with less useful information. This is because the Italian reporting environment can be characterised by a weak corporate governance system and low financial transparency, leading to potentially opportunistic behaviour by managers. Further, although the aggregate of the identifiable intangible assets is found to exhibit overall lower value relevance after IFRS adoption, only two classes of the assets such as licences and deferred costs experience a significant decrease in value relevance.

In the Portuguese market, a study conducted by Oliveira, Rodrigues and Craig (2010), find that goodwill and the aggregate amount of identifiable intangible assets reported under the Portuguese GAAP are value relevant. However, when considering the subclasses of identifiable intangible assets, the amounts recognised for intellectual property and R&D expenditures do not appear to be value relevant. The findings also suggest that, while the adoption of IFRS had no impact on

the value relevance of identifiable intangible assets as a whole, it has a positive effect on the value relevance of goodwill. Further, when the subclasses of identifiable intangible assets are analysed, evidence of an increase in the value relevance is found for other identifiable intangible assets such as start-up costs, intangible assets in development and prepayments for purchases of identifiable intangible assets and capitalised Research and Development costs. They argue that the change in the accounting system potentially reduce earnings manipulation practices due to more restrictive requirements, thus leading to the recognised amounts of these expenditures being regarded by the investors as having future economic benefits.

Other studies suggest that, a less conservative accounting method choice that allowed intangible assets to be recognised as assets rather than expensed when incurred has the potential to provide more relevant information to investors, there are also studies that provide no support for this proposition. Nonetheless, the overall results indicate that the disclosure of non-financial information that captures the notion of intangible assets results in improved information usefulness. Further, the introduction of the new accounting regime (IFRS) is found to have an impact on the value relevance of intangible assets and that this impact varies depending on the accounting regulatory environment. Figure 1 below is a comparative of the historical cost basis of accounting and the fair value/ current value accounting.

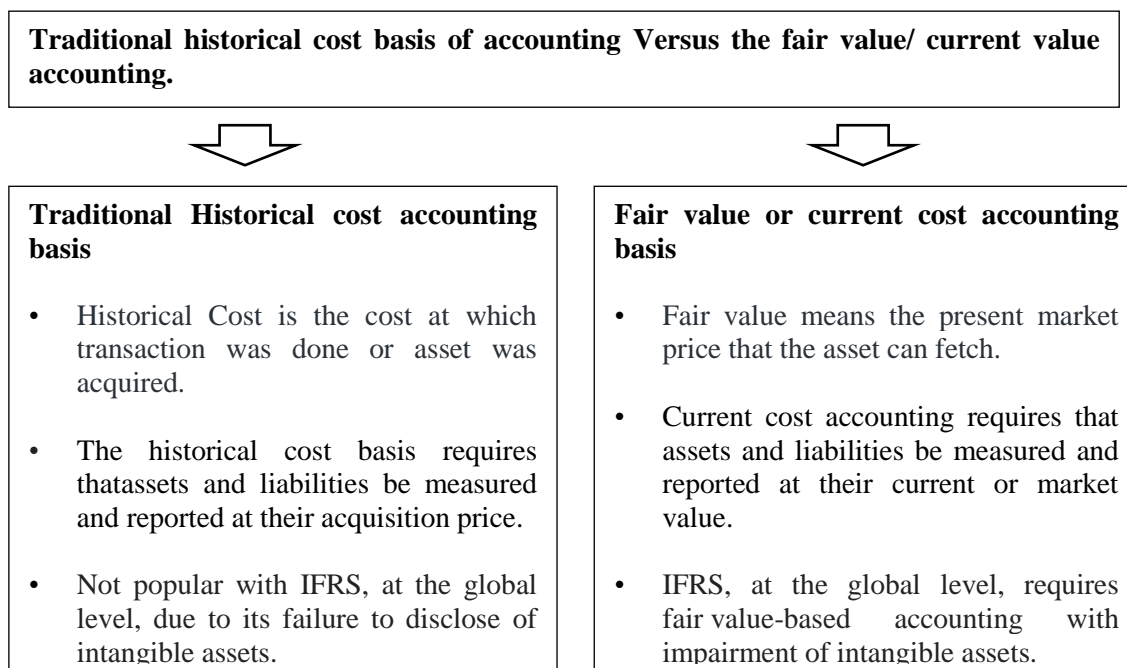


Figure 1. Traditional Historical cost basis and the fair value accounting basis.

source: The researcher

Traditional Historical cost accounting reports assets and liabilities at the initial price they were exchanged for at the time of the transaction. Conversely, fair value accounting quotes the prevailing price in the market. Nevertheless, while both methods of accounting affect financial statements, the impact of fair value accounting on the balance sheet and income statement is extreme due to the potential volatility of the method. Fair value accounting is deemed superior

when compared to historical cost accounting because it reflects the current situation in the market whereas the latter is based on the past. In addition, in relative terms, fair value accounting provides users with more current financial information visibility and disclosure of intangible assets. (Paul Jajairam 2013)

3. RESEARCH METHODOLOGY

The study was persuaded to use both quantitative and qualitative research methodology since both quantitative and qualitative research approaches are helpful in the collection and analysis of information in as many forms as possible including constructivist approach meaning that, the study used mixed research approach. The design adopted for this study is a descriptive survey where the questionnaire was used in collection of data. The study population was 600 respondents from which a sample of 100 participants was drawn from all the three Telecommunication companies, TelOne, Econet and Telecel Zimbabwe branches in Bulawayo, Post and Telecommunication Regulatory Authority of Zimbabwe (POTRAZ), Institute of Chartered Accountants Zimbabwe (ICAZ), External auditors and the parent Ministry of Information, Communication Technology. Snowball and purposive sample size selection techniques were used due to the descriptive nature of the study. Snowball sampling method was applied on the three Telecommunications companies' boards of directors, audit committees and external auditors while purposive sampling technique was applied on the management of the three Telecommunications Companies, POTRAZ Officials, ICAZ Officials, Internal Auditors, and the Ministry of Information Communication Technology Officials.

4. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

- **Disclosure of intellectual property as a major intangible asset in highly intensive knowledge firms**

Under IFRs 3 which deals with intangibles and given that, intellectual property is a major intangible asset, in the telecommunication industry; respondents were asked whether in their company's intellectual property was ever reported in their financial reports presented to users. Results were as shown in Table 1 below.

Table 1: Disclosure of intellectual property in TelOne; Econet Zimbabwe and Telecel Zimbabwe financial reports

Responses	Frequency (N=60)	% Of actual respondents
Yes	28	47%
No	32	53%
Total	60	100%

Source: Research data

The Table 1 above reveals that, out of the 60 respondents, a group representing 47% said that, there was disclosure of intellectual property while 53% said that, there no disclosure of intellectual property in the Zimbabwean telecommunication industry. Basing on the data presented and analysed in Table 1 above, the study concludes that, in some highly intensive knowledge based firms such as the Econet and the Telecel, intellectual property was being

disclosed to a limited extent while in the TelOne (Pvt) Ltd company, there was no disclosure at all implying that, TelOne (Pvt) Ltd is not a public reporting company like Econet and Telecel Zimbabwe limited. That is to say, TelOne management has discretion to report to the public through parliament if called to do so. On further probing, those disclosing intellectual property (intangible assets) in their financial reports, respondents indicated that, they disclose them in a footnote below the balance sheet or as statement, however not in monetary value. This conclusion appear to be in line with the findings by Rylander et al., (2000); Abdel-Khalik, (2003) who both suggest an extension of the balance sheet with complementary balance sheets, or a supplementary set of elements in reporting to acknowledge forms of capital that cannot be measured in financial terms, to recognise intellectual capital in financial reports. The study may further argue that, most intangible assets disclosure was in narrative format (Beattie and Thomson, 2007) and this has been also limited. In view of the respondents who answered ‘no’ in Table 1 above, the implication was that, there was no disclosure of intellectual property (intangible assets) such as human capital, skills, technological know-how in high tech economies creating information asymmetry gap between management and shareholders. The study encourages a paradigm shift from the traditional accounting system and embrace modern day accounting practices such as IFRS which recognize disclosure of intangible assets to increase transparency, comparability, and the integrity of financial reports to users for them to be able to make sound economic decisions.

- **Accounting basis adopted to enhance value relevance of financial information**

A question was asked to establish accounting basis adopted by preparers of financial statements to enhance value relevance to both internal and external users. Results for the question was presented on the Table 2 below

Table 2: Accounting basis adopted to enhance value relevance of financial information

Responses	Frequency (N=60)	% Of actual respondents
Hyperinflationary Adjusted Accounting Method	4	7%
Historic Cost Accounting Method	16	27%
Fair Value Accounting Method	22	37%
Traditional financial accounting Method	12	20%
Net Realisable Value Accounting Method	6	10%
Total	60	100%

Source: Research data

Data presented on Table.2 above reveals that, out of 60 respondents surveyed, a group representing 7% believed that the three companies under investigation adopted hyperinflationary adjusted accounting method; 27% were of the view that, Historic Cost Accounting Method was adopted while 37% believed that Fair Value Accounting Method was adopted. A group representing 20% said that, traditional financial accounting method was adopted while 10% stated that, the companies adopted Net Realisable Value Accounting Method. These results concur with Paul Jajairam (2013) who concluded in their study that fair value accounting is deemed superior when compared to historical cost accounting because it reflects the current situation in the market and better account for intangibles whereas the later is based on the past. Bello A. Sulaimon (2014) however dispute the superiority alluding that all the methods have important roles to play in structuring financial disclosure and ensuring that needed information is

available to different groups of users. Basing on data presented and analysed in Table 2 above, the study concludes that, though TelOne; Econet and Telecel, were still using historic cost accounting, these companies were less value relevance since historic cost accounting has some noticeable weaknesses one of which failure to measure and adequately disclose intangible assets which constitute bulky in new economy firms, thus which causes it to be viewed as a method that provide inadequate information to all stakeholders to enable them make informed business decisions.

Rating a statement on the usefulness of accounting information under historic cost Accounting

A question for rating the usefulness of accounting information under historic cost accounting was asked. Rate of responses were 1; 2; 3; 4; & 5 where 1=strongly disagree; 2 = disagree; 3= Did not know; 4= agree and 5= strongly agree. Results for the question is presented on the Table 3 below

Table 3: Results of rating of the usefulness of accounting information under historic cost Accounting basis

Rating scale	1	2	3	4	5	%
Accounting has failed to provide an accurate view of intangible assets as value drivers of future economic benefit and therefore traditional historical cost financial statements have experienced a dramatic loss of value relevance	2%	3%	5%	20%	70%	100 %

Source: Research data

Data presented on Table 3 above reveals that, out of 60 respondents surveyed, a group representing 2% strongly disagree that, accounting has failed to provide an accurate view of intangible assets as value drivers of future economic benefit and therefore traditional historical cost financial statements have experienced a dramatic loss of value relevance; 3% disagree while 5% did not know. A group representing 20% agree that, accounting has failed to provide an accurate view of intangible assets as value drivers of future economic benefit and therefore traditional historical cost financial statements have experienced a dramatic loss of value relevance, while 70% strongly agrees. Basing on data presentation and analysis in Table 3 above, the study concludes that, due to the failure of accounting standard setters to provide an accurate view of intangible assets as value drivers of future economic benefit and continued use of traditional historical cost financial statements in the knowledge intensive telecommunication industry result in a dramatic loss of value relevance of financial reports to the users. These findings in Table 3 above concurs with the results of the studies carried out by Amir and Lev, (1996); Lev and Sougiannis, (1996); Collins et al., (1997); Lev and Zarowin, (1999) which attribute the documented decline in the value relevance of financial information due to the inadequate treatment of intangible assets particularly given that there is dramatic change in the business environment and the increasing importance of intangible investments in new economy firms.

5. CONCLUSIONS COMMENDATIONS

The study concludes that, though TelOne; Econet and Telecel, were still using historic cost accounting, these companies were less value relevance since historic cost accounting has some

noticeable weaknesses which causes it to be viewed as a method that provide inadequate information to shareholders, creditors and all stakeholders to enable them make informed business decisions. Basing on data presentation and analysis in Tables 1,2, and 3 above, the study concludes that, due to the failure of accounting standard setters to provide an accurate view of intangible assets as value drivers of future economic benefit and continued use of traditional historical cost financial statements in the knowledge intensive telecommunication industry result in a dramatic loss of value relevance of financial reports to the users.

RECOMMENDATIONS

- The study recommends that, fair value accounting method which recognizes intangible assets enhance value relevance of accounting information to users hence should be used other than the traditional historical cost accounting basis.
- TelOne (Pvt) Ltd; Econet and Telecel should seek more use of professionals in accounting in applying the IFRS in financial statements and presentation in order to create value relevance of financial information to users to help them make informed economic decisions.
- The audit committee members and top management in the three-telecommunication sector, should be involved in providing quality financial statements not only putting emphasis on company's performance in terms of turnover but also in terms of financial reporting to both internal and external users.
- The capacity to prepare and present financial statements conforming to accounting standards need to be exploited other than being kept idle by the companies.

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