



## **Fair value measurement and financial statement reporting of listed conglomerate companies in Nigeria**

<sup>1</sup>EMMANUEL Isaac Buba; <sup>2</sup>USMAN Tanimu Gadi; & <sup>3</sup>ISAAC Helen Abrak

<sup>1&3</sup>Bursary Department, Bingham University Kodape, Karu, Nasarawa State

<sup>2</sup>Department of Accounting, Nasarawa State University, Keffi, Nasarawa State

### **ABSTRACT**

*The study examined effect of fair value measurement on financial statement reporting of listed conglomerate companies in Nigeria. This study adopts a survey research design which allows for employing a comprehensible research instrument in gathering data for the study. Descriptive statistics is employed to analyze quantitative data using regression analysis. The study found that fair value measurement reliability has a positive significant effect on financial statement reporting, fair value measurement transparency has a positive but insignificant effect on financial statement reporting and; fair value measurement sufficient precision has a positive insignificant effect on the financial statement reporting of conglomerate companies. The study concludes that financial reporting differs significantly when measured with fair value and historical costs. Thus, the study recommends that conglomerates companies should adopt a hybrid form of measurement (measurements which entail both fair and historical values) in reporting their activities to reflect actual value creation. Furthermore, International Accounting Standards should review the current provisions on the fair value practices in the International Financial Reporting Standards to ensure improved operations of firms across national borders.*

**Keywords:** *fair value measurement, financial statement reporting, Reliability, Transparency*

### **Introduction**

Accounting practices and financial reporting world over is premised on a cardinal concept known as money measurement. Egbe (2014) asserts that money measurements of accounting events and items are essentially a process of valuation. The valuation in accounting measurements in that regard is that, 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 tomorrow, since the purchasing power of money over goods and services changes. Also, the use of money measurement in accounting implies a choice between one of the several different valuation bases (Egbe, 2014).



Notably, the whole essence of financial reports is to convey realistic, timely, accurate and relevant information to the varied groups and stakeholders of an organization. Elfaki and Hammad (2015) in this regard observed that the quality of information concepts of accounting information is based on such characteristics as objectivity, relevance, reliability, neutrality, capability of information for comparison, materiality and full disclosure. In essence, the objective of financial reporting is to provide useful information about the reporting entity to existing and potential investors, lenders and other creditors in making capital-allocation decisions (IASB, 2011). According to International Accounting Standard Board (IASB), financial statements information should provide users with information that is useful to investors, creditors, and all expected users in making rational investment, credit, and any expected decisions. A beneficial accounting system should produce information with high quality that is both reliable and relevant for decision making.

Fair value accounting measurement has become applicable in Nigeria in the determination of firm value and profitability following the adoption of the International Financial Reporting Standard (IFRS) by the Federal Executive Council (FEC) of Nigeria on July 28, 2010 (Abiahu, Udeh & Ogbekhilu, 2018). The essence of the adoption was to promote higher quality of financial reporting information, and to improve comparability and transparency of financial reports in Nigeria. In many developing countries, fair value accounting (FVA) considered a suitable measurement that is more relevant than historical cost accounting model, but it is still questionable whether fair value information provides more appropriate information than that of historical cost in these emerging markets with weak financial markets? And whether the (IFRS) fair value measurements can or should be implemented in those markets (Fadia & Mohammad, 2015).

Fair value accounting measurements in developing countries was criticized that, it's irrelevant for many reasons: for instance, unavailability of efficient markets for many assets and liabilities, which makes fair value measurements are a type of management estimation that are subjective and less relevant and unreliable for decision making. Another problem appears in developing countries is the cost benefit problem when producing fair value information; it's argued that, it is too costly for small companies to apply fair value measurements while the expected results are unbeneficial. The final problem for these countries also appears when income is recognized under fair values measurements, which makes the reported unrealized gains or losses resulted from fair value



appears in financial statements' information, which might cause greater volatility in returns, share prices and unpredictable market conditions (Barth, 2006).

In developing countries, the lack of active markets for many assets, like financial instruments and investment properties affect level three of fair value measurement. This level is applied by managers through estimations and prediction, it's argued that, manager's predictions or estimations might be applied with subjective methods that result in discretion or manipulation of accounting numbers. The necessity to reach high comparability and harmony internationally, the (IASB) worked hardly through the previous period to increase international harmonization of accounting standards. The (IASB) work resulted in a production of a set of International Financial Reporting Standards (IFRS) that has been implemented and adopted fully or partially in many countries worldwide. Interestingly, many developing countries conversed to IFRS since the year 2011, some researchers argued that, it is too early to give judgments for such conversion especially for emerging thin markets because there are many doubts about this convergence whether it will make a difference at all (Olesen & Cheng, 2011).

Despite these concerns, there are still inadequate study to support or refute the above assertion. The available studies such as Fadia and Mohammad (2015), Beesong and Charles (2012) can only account for this peculiarity on fair value measurement in the developed nation. Even the available ones in Nigeria such as Abiahu, et al. (2020), Gospel and Akpeekon (2019), Akwu et al (2017), are not carried out in the conglomerate firms. Therefore, there is need for this study in the Nigeria conglomerate companies.

The study examined the effect of fair value measurement on financial statement reporting of listed conglomerate companies in Nigeria while the following hypotheses were tested as a guide to provide answer to the questions raised:

Ho1: Fair value measurement reliability has no significant effect on the financial statement reporting of listed conglomerate companies in Nigeria.

Ho2: Fair value measurement transparency has no significant effect on financial statement reporting of listed conglomerate companies in Nigeria.



Ho3: Sufficient precision of fair Value Measurement has no significant effect on the firm's financial position and earning potential?

## **Literature Review**

### **Fair Value Measurement**

Fair value accounting was proposed as an optional measurement in replacement of historical cost for a set of assets and liabilities. Fair value of a certain assets has been perceived more relevant than historical cost, for example; financial instruments and investment properties, but in some situations fair value is considered to be less reliable than historical cost if current market prices are unavailable. Therefore, fair values of some assets have been seen as reflecting the market's assessment of the effects for current economic conditions on these assets, and thus do not affect by the past events of such assets or the by firm that holds them (Alkhadash & Abdullatif, 2009), this in turn allows adequate financial statement reflection of asset liability management activities when fair value accounting is implemented for all financial assets (Siam & Abdullatif, 2011).

John and Goind (2012) opined that the guidance on fair value under the current International Financial Reporting Standards (IFRS) is covered by a number of different standards. Recently, a new standard for accounting for measurement of fair value is issued by the international Accounting Standard Board (IASB) and this forms a single framework for fair 'value measurement; where it is required or accepted under IFRS.

Fair value, according to the International Financial Reporting Standards (2011) (as cited in Amanamah & Owusu, 2016) is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted it could be exchanged between knowledgeable, willing parties in an arm's length transaction. Ashford (2011) views fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement dates. Jarolim and Oppinger (2012) define fair value as the amount which could be transferred in a fictitious transaction between knowledgeable, willing parties under normal market conditions (arm's length transaction). Therefore, the fair value constitutes a hypothetical market price under idealized market environment. Thus, fair value accounting revolves around recording changes in market values. This results in the recognition of unrealized



gains and losses. Unrealized gains and losses will only have an impact on cash flow if sold on the balance sheet date. Fair value is sometimes referred to as “exit values”, however, when fair value is not available due to lack of an actual transaction, it is logical to use information from an active market.

### **Financial Reporting**

Financial reporting is the product of accounting system that reflects unobservable construct that inherently involves estimations and judgments, and thus has the potential for unintentional errors and intentional bias (Ewert & Wagenhoper, 2010). They further explain that, financial reporting quality is one of the most important characteristics of accounting systems. High quality in this regard is said to improve capital market efficiency as such investors and other users should be interested in high quality financial accounting information. for that reason, standards setters strive to develop accounting standards that improve earnings quality, and many recent changes in auditing, corporate governance, and enforcement have similar objective (dechow, Ge & Schrand, 2010).

### **Firms' Performance**

Performance measurement according to Al-Matari, Al-Swidi and Fadzil (2014) refers to the process of measuring the action's efficiency and effectiveness. Organizational performance can be defined as the actual results generated by an organization as measured against the organization's stated goals and objectives. It can be seen as an indicator to measure the effectiveness of an organization in running its daily operations. This will determine whether organizations are able to survive in the market or not. Niresh and Velnampy (2014) opine that firm performance can be measured in different ways and by applying various methods; and the commonly used method for financial analysis is the use of profitability ratios as key measures of firms' overall efficiency and performance. Richard, Devinney, Yip and Johnson (2009) note that organizational/firm's performance encompasses three specific areas which comprises of financial performance, shareholders return and market performance.



## **Theoretical Background**

**Agency Theory:** According to Egbunike and Abiahu (2017), Agency theory has been widely used in literature to investigate the information asymmetry between principals (shareholders) and agent (management)". Jensen and Meckling (1976) describe the agency theory as constituting a contract where the shareholders (the principal) engage the managers (the agent) to manage the firm's operations in an efficient and effective way. A major problem that can result from this agency relationship is the problem of information asymmetry between the managers and shareholders, as managers may possess superior information about the current and expected future performance of the firm when compared to the information available to shareholders.

Arnold and Lange (2004) cited in Okaro, Okafor and Okoye (2015) stated that two agency problems exist in an information asymmetry situation. First, adverse selection where the principal cannot determine if the agent is performing the work for which he/she is paid, and secondly, moral hazard where the principal is unsure as to whether the agent has performed their work to their ability. When the interests and functions of the self-serving agents coincide with those of the principals, agency problem will not arise. However, when there is divergence, agency costs are incurred by the principals because the agents will want to maximize their own utility at the expense of the principals (Udeh, Abiahu & Tambou, 2017).

## **Empirical Review**

Gospel and Akpeekon (2019) examined the relationship between fair value accounting and financial performance of manufacturing companies in Nigeria. The study adopted a descriptive and quasi-experimental design in a bid to achieve a holistic evaluation of the effect of fair value accounting on the financial performance of manufacturing companies in Nigeria. The data employed in the study was generated from the annual reports of ten (10) selected manufacturing companies listed on the Nigeria Stock Exchange from 2008-2010 (representing historical cost regimes) and 2014-2016 (representing fair value regimes). The paper formulated four hypotheses. It tested the hypotheses using least square method of multiple regression. The result showed that fair value accounting has a positive and significant impact on both profit before tax and return on assets. It is therefore recommended that fair value accounting should be adopted in order to achieve a more realistic measurement of financial performance the one under the historical cost basis.



Abiahu, et al. (2020) evaluated the effect of fair value reporting on financial profitability and firm value with focus on deposit money banks listed on the Nigerian Stock Exchange Using a sample of 13 banks listed on the Exchange, the study employed secondary data gathered from published annual reports of eight years (four years pre-IFRS, historical value measurement and four years post-IFRS fair value measurement) 2008 to 2015. The descriptive analysis was employed to summarize data collected while SPSS Version 23 software and regression analysis were used to analyze data. The result support the hypothesis that fair value reporting does not significantly affect reported profitability. Fair value was however found to affect firm valuation.

Leonard, et al. (2018) examined the effect of fair value measurement (FVM) and historical cost accounting (HCA) on the performance of listed firms in Nigeria. Data were sourced from the online published accounts of ten listed firms for a period of ten years segregated into HCA regime (2007 – 2011) and FVM regime (2012- 2016). Descriptive Statistics (Mean) and Inferential Statistics (Paired sample t-test) were employed in the analysis. Findings from the analysis revealed that a positive but insignificant difference exists in the profit after tax of the firms between the FVM and HCA regimes; and that fair value measurement exerts negative but insignificant effect on the earnings per share and return on equity of the firms. The study thus concluded that fair value measurement as it is being practiced and implemented by Nigerian firms, exerts no significant change in firms' performance as was reported under the HCA regime.

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

Alkababji (2016) carried out an exploratory study designed to investigate the extent of compliance with the requirements fair value measurement disclosures in the annual reports of the 48 corporate firms that were listed on the Palestine Exchange (PEX) in 2014, by firstly sketching a guide of



best practices and examining the relationship between the disclosure requirements for fair value measurement and the variables which may determine. The study developed and utilized a disclosure score called unweighted fair value disclosure index (FVDI) to measure the extent of disclosure made by companies in corporate annual reports, and then using a statistical program to run the Correlations test, and Analysis of variance test. This study reports significant differences in levels of disclosures on fair value measurements, as measured by the mean values of the fair value disclosure index in Palestine. The findings show that, there is correlation between the disclosure requirements for fair value measurement and the explanatory variables (the size of the firm, auditor's type), also there are differences in the level of disclosure requirements for fair value measurement of the firms due to the kind of economic sector.

Fadia and Mohammad (2015) used a quantitative methodology in addressing the relevance of fair value measurement applications for investment properties on the financial performance of Jordanian firms, its share prices and market values, the study also examined the effect of unrealized gains and losses on financial statements. Ohlson (1995) theoretical frameworks have been used to examine this relationship. A sample of Jordanian firms (consisting of 41 real estate companies) listed in the Amman stock exchange during the 2008–2011 time period has been used. The study findings, based on the results of multiple regression analysis showed that financial performance of Jordanian real estate companies is significantly positively related to investment properties valued at fair values. Furthermore, the book value incremental information content is greater than information content of the net income and the unrealized gain & losses inclusion in owners' equity increases the explanatory power of the firm's market value model of real estate companies. This study concludes that fair value accounting measurements for Jordanian real estate companies have been value relevant during all the period of the study.

Beesong and Charles (2012) in their study, examined the effect fair value accounting and historical cost accounting has on the reported profits of manufacturing companies in Nigeria. With the use of multiple regression methods, secondary data employed were evaluated. The aim of this, was to create the relationship between the dependent and independent variables. Depreciation, dividend and taxation were the explanatory variables used in their study. The results obtained revealed that the technique utilised for measuring profit has direct influence on the amount calculated as



depreciation, determines the amount charged as taxes and stipulates the amount paid as dividend from the reported profit of a given time frame.

### **Methodology**

This study adopts a survey research design. Survey research design allows for employing a comprehensible research instrument in gathering data for the study. The target population for the research consists of listed Conglomerate companies in Nigeria. However, since the study adopt primary sources of data collection, the sample size is restricted to John Holt Plc. and SCOA Nig. Plc based in Abuja, Nigeria. Descriptive statistics is employed to analyze quantitative data. The descriptive analysis is done using frequency distribution table, means and percentages. Statistical inference is conducted using correlation analysis, and regression analysis.

### **Model Specification**

The linear relationship between the variables is depicted thus:

$$FSR = a + \beta_1 FVMR + \beta_2 FVMT + \beta_3 FVMSP + \mathcal{E}$$

Where;

FVMR = Fair Value Measurement Reliability

FVMT = Fair value measurement transparency

FVMSP = Fair value measurement sufficient precision

FSR = Financial Statement Reporting

a = Constant term

$\beta_1$ -  $\beta_3$ = Estimates of the regression parameters

$\mathcal{E}$  = Stochastic error



**Results and Discussion**

**Table 1 Correlation Result**

		FSR	FVMR	FVMT	FVMSP
	Pearson Correlation	1			
FSR	Sig. (2-tailed)				
	N	350			
	Pearson Correlation	.983**	1		
FVMR	Sig. (2-tailed)	.000			
	N	350	350		
	Pearson Correlation	.989**	.990**	1	
FVMT	Sig. (2-tailed)	.000	.000		
	N	350	350	350	
	Pearson Correlation	.908**	.873**	.900**	1
FVMSP	Sig. (2-tailed)	.000	.000	.000	
	N	350	350	350	350

\*\* . Correlation is significant at the 0.01 level (2-tailed).

**Source: SPSS Output, 2022**

Pearson Bivariate Correlation test has been used to test the relationships between variables and sub-variables. The result above shows that the relationships among the variables are strong, where fair value measurement reliability has a positive correlation with financial statement reporting to the extent of 98.3%. In the same way, the result shows that fair value measurement transparency has positive correlation with financial statement reporting to the extent of 98.9%. Furthermore, the result shows that fair value measurement sufficient precision is positively correlated with financial statement reporting to the extent of 90.8%. The result indicates high correlation between the variables.



**Test of Hypothesis**

**Table 2: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.994 <sup>a</sup>	.988	.988	.10930

a. Predictors: (Constant), FVMR, FVMT, FVMSP

**Source: SPSS Output, 2022**

The model shows that fair value measurement variables explained 98.8% variation on the financial statement reporting in conglomerate, while the remaining 1.2% variation is explained by other variables not included in the model of this study. This therefore means that financial statement reporting of conglomerate firms should under its market when trying to estimate its asset fair value and reporting in the annual report because it will either improve its financial statement reporting or decrease its reliability and accuracy.

**Table 3: ANOVA**

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	333.750	5	66.750	5587.241	.000 <sup>b</sup>
	Residual	4.110	344	.012		
	Total	337.860	349			

a. Dependent Variable: FSR

b. Predictors: (Constant), FVMR, FVMT, FVMSP

**Source: SPSS Output, 2022**

The result above shows the significant level of the fair value measurement with the financial statement reporting of conglomerate companies in Nigeria. The result shows that the model is fit at less than 5% level of significance (95% level of confidence) which means



that all the variable are well stated and they have significant effect on the financial statement reporting.

**Table 4: Coefficient**

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.061	.031		-1.926	.055
	FVMR	.154	.060	.211	2.556	.011
	FVMT	.033	.019	.049	1.696	.091
	FVMSP	.097	.101	.092	.961	.337

a. Dependent Variable: FSR

**Source: SPSS Output, 2022**

The result above was used to test the hypotheses, the result found that fair value measurement reliability has a positive significant effect on financial statement reporting of conglomerate companies in Nigeria with p-value less than 5% level of significance. It therefore signifies that increase in the reliability of the company’s asset; it will increase their financial statement reporting.

Fair value measurement transparency has a positive but insignificant effect on financial statement reporting of conglomerate companies in Nigeria with p-value greater than 5% level of significance.

In the same way, fair value measurement sufficient precision has a positive insignificant effect on the financial statement reporting of conglomerate companies.



## Summary of Findings

This study examines the effect of Fair Value Measurements (FVM) on financial statement reporting. From the responses, it argues that lack of agreement on FVM objectives and defining fair value in terms of prices that would have obtained in a hypothetical market transaction between willing buyers and sellers are potential sources of reliability problems.

The major concerns about the reliability of fair value is the absence of active markets for many assets and liabilities. This could result in the possible misuse of fair value. The finding that fair value is value-relevant does not resolve the issue of whether fair value is to be preferred over alternative measurement attributes. Furthermore, there are concerns whether FVM is relevant for all items in the balance sheet. For instance, for assets whose value in use exceeds market price because of entity-specific advantages not enjoyed by market participants, fair value may not be the most relevant measurement attribute. Furthermore, incorporating fair value of actively traded financial instruments may result in putting speculative prices on financial statements.

This further buttress the assertion of IFRS 13 which requires a number of quantitative and qualitative disclosures about fair value measurements. Many of these are related to the following three-level fair value hierarchy on the basis of the inputs to the valuation technique: Level 1 inputs are fully observable (e.g. unadjusted listed prices in an active market for identical assets and liabilities that the entity can access at the measurement date); Level 2 inputs are those other than listed prices within Level 1 that are directly or indirectly observable; and Level 3 inputs are unobservable. The major challenge to fair value reliability is the concern of level 3 without precise market for unobservable inputs in the sector.

Also, by comparing the measurement application at fair value in the research sample with the application of historical cost measurement; the level of transparency in the financial statements was increased. Many important results were obtained; that level of transparency in financial statements when applying the measurement at fair value is higher than the level of transparency when applying historical cost, fair value measurement improves comparing of financial statements in various financial entities that application international accounting standards, and international



financial reporting. The basis of differentiation between them and the measurement of historical cost is to achieve the required saucepan of relevance and faithful representation.

Furthermore, the finding of the study, it was observed that the implementation of Fair Value measurements gives sufficient precision in assessing firm's financial position and earning potential. Also observed was that the possibility of measurement errors in financial asset measured on Fair Value basis was high. Hence, it is obvious that fair values are not necessarily the currently realizable values of positions rather they are hypothetical value that reflect transaction prices even if current conditions do not support such transaction. Fair value reflects current information about future cash flows and current risk adjusted discount rates. It does not allow firms to manage their income through gains trading, because gains and losses are recognized when they occur, not when they are realized

### **Conclusion and Recommendations**

The popularity of fair value measurement has been on the rise since the move towards global convergence of financial reporting. This has arisen from the adoption of IFRS by different nations of the world. These global standards set to harmonize accounting practices and improve the usefulness of accounting information advocated those items in financial statements are reported fairly. Contradictory views have however risen over time on how much fair value has achieved the purpose of financial statements and the usefulness of accounting information. Based on the results from the analyses of this study, the financial reporting differs significantly when measured with fair value and historical costs.

Overall, the study concludes that in order to effectively evaluate financial reporting, knowledge of fair value is not enough. Users also need to know the historical cost of the investment. Therefore, companies should adopt a hybrid form of measurement (measurements which entail both fair and historical values) in reporting their activities to reflect actual value creation. Also, Auditors should examine financial statements with due care to ensure true and fair reporting by directors.

Furthermore, International Accounting Standards should review the current provisions on the fair value practices in the International Financial Reporting Standards to ensure improved operations of firms across national borders.



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