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Fair Value Accounting and Earnings Quality of Quoted Commercial Banks in Nigeria

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Abstract

This study investigated the impact of fair value accounting on earnings quality of selected banks in Nigeria. It examined how fair value adoption influences earnings quality by analyzing data from eight commercial banks from 2013 to 2023. The dependent variable, earnings quality, was measured using earnings predictability, while the independent variables include fair value accounting (through other comprehensive income, net operating income, the logarithm of total asset values, and leverage). Using ex-post facto research design and panel data regression analysis, the study finds evidence that all independent variables fair value accounting significantly affect earnings quality. The study recommends that bank management should consider market conditions and economic implications when adopting fair value accounting. Additionally, financial statement regulators should establish conditions that support the effective application of fair value accounting to avoid impairing earnings quality.

Keywords: *Fair values, Earnings quality, Firm Size, leverage*

1. INTRODUCTION

Since January 1, 2012, publicly traded companies in Nigeria have been mandated to prepare their annual financial statements and other reports in accordance with the International Financial Reporting Standards (IFRS) which are developed and approved by the International Accounting Standards Board (IASB), (Ijeoma, 2019).. Under IAS 40, companies have the option to report investment properties using either the fair value model or the historical cost model The choice between these methods significantly influences the reported earnings of the entity (Rhee, Yoo & Cha, 2016; Leuz, Nanda & Wysocki, 2018).

Fair value accounting involves adjusting the value of assets in financial statements to reflect changes in market prices (IASB, 2003). Fair Value Accounting (FVA) is described as the method by which firms continuously measure and report certain assets or liabilities, particularly financial instruments, at their current market value—the amount that would be received if the assets were sold or the amount to be paid to settle liabilities (Ryan, 2018; Ijeoma, 2019). According to Generally Accepted Accounting Principles (GAAP), fair value is defined as the amount at which

an asset could be bought or sold in an active market or the amount that could be incurred or settled in a current transaction between willing parties, excluding liquidation values. It is considered a key market feature for evaluating the quality of financial reporting (Prochazka, 2011). Power (2013) suggests that fair value accounting provides a more accurate reflection of economic changes, including net assets and earnings, compared to historical cost accounting.

Earnings provide critical information for stakeholders and are crucial for investment decisions (Francis, LaFond, Olsson & Schipper, 2004; Ebirien & Nwanyanwu, 2017). According to Schipper and Vincent (2003) and Dechow, Ge, and Schrand (2010), high-quality earnings should accurately reflect a firm's current operating profit, future performance, and intrinsic value. Empirical studies have shown that poor earnings quality increases information risks and raises the cost of equity (Francis et al., 2016).

Earnings quality has attracted significant attention from scholars, standard setters, professionals, and other stakeholders due to its importance in evaluating financial performance. It is a crucial parameter in assessing the sustainability, competitiveness, and growth of companies, particularly within the banking sector (Gadhia, 2015; Lang, Raedy & Wilson, 2016). High earnings quality indicates that a company's financial statements provide an accurate and transparent view of its financial performance. Conversely, low earnings quality is characterized by inaccurate, misleading, or opaque financial statements.

Dechow, Ge, and Schrand (2015) assert that high-quality reported earnings reflect current operating profitability, project future performance, and accurately represent a firm's intrinsic value. Since the adoption of International Financial Reporting Standards (IFRS), there has been considerable attention on earnings quality, partly because fair value accounting has previously been shown to diminish earnings quality (Ebirien and Nwanyanwu, 2017). The shift from a historical cost-based accounting model to a fair value (or market value) accounting model significantly impacts the nature and role of financial reporting (Okpara & Iheanacho, 2020). When evaluating the effectiveness of fair value accounting, it is essential to consider how it serves the overarching objective of financial reporting, which is to provide relevant decision-making information to investors, creditors, and other stakeholders (IASB, 2010).

Young (2015) uses the term earnings management to describe instances where managers alter external reporting to modify the economic performance reflected in financial statements. Nigeria experienced 45 bank failures between 1994 and 2006, including several major institutions previously considered stable. In 2007, the Central Bank of Nigeria (CBN) liquidated 14 banks (NDIC), and in 2009, former CBN governor Sanusi Lamido Sanusi allocated N420 billion to rescue five failing banks—Oceanic Bank, Intercontinental Bank, Finbank, Afribank, and Union Bank—which contributed to the depreciation of the Naira (Africa Research Bulletin, 2009). Investors faced significant losses totaling N83 billion from the nationalization of Keystone Bank Limited, Main-Street Bank, and Enterprise Bank, and an additional N10.69 billion loss from the closure of Skye Bank (Orji, 2018). This trend indicates that bank failures have become increasingly

common in Nigeria.

Ultimately, accounting reports must provide value-relevant information, as the primary role of accounting information is to inform. Ronen and Yaari (2018) has reported that the need for informative reports arises from investors' demands for data to project future earnings and cash flows. This underscores the importance of reported earnings quality and the need to investigate factors that impact it.

Accounting reports should deliver value-relevant information, as their main function is to enlighten. According to Ronen and Yaari (2018), the informational purpose is driven by investors' requirements for data to forecast future earnings and cash flows. This necessitates a focus on earnings quality and an exploration of elements that may influence it. Research by Paoloni, Paolucci, and Menicucci (2017) on fair value accounting and earnings quality in Europe highlights a gap in research concerning the impact of fair value on earnings quality in Commercial Banks.

Fair value measurement is a significant aspect of the adoption of IFRS and may have a profound effectt on financial reporting by banks in several ways, particularly through the valuation of financial instruments as outlined in IFRS-13: "Fair Value Measurement" and also IFRS-9 "Financial Instruments." These standards necessitate the use of fair value for a substantial portion of debt and equity securities. The sensitivity of these valuations and their results is closely linked to reported earnings, making the understanding and application of these standards crucial for accurate financial reporting.

Banks, as well as other businesses, use reported profits to convey firm-specific information to their stakeholders. Profits serve as a strong predictor of future cash flows and provide more insight into a company's economic performance than cash flows alone. Earnings are seen as a key indicator of profitability and a primary source of financial data in capital markets. Earnings offer critical insights into a company's value, prompting financial market participants, especially investors and analysts, to closely monitor earnings quality to make informed investment decisions.

Fair value accounting has faced criticism for causing increased volatility in earnings and balance sheet metrics such as capital and management compensation, particularly within the banking sector. This volatility may incentivize unethical managers to engage in earnings management, using tactics like earnings smoothing to mitigate the appearance of risk and stabilize compensation or regulatory capital (Baffh, Gomez-Biscarri, Kasznik, & Lopez-Espinosa, 2015). Proponents of fair value accounting argue that it provides a more accurate depiction of a bank’s risk exposure, especially during volatile periods, by reflecting risk elements not captured by non-fair value revenue measurements. However, it is essential to acknowledge that the current fair value accounting requirements could still permit earnings management. Therefore, the question of whether fair value accounting affects earnings quality in Nigerian banks, including the nature and significance of this effect, remains unresolved.

This conceptual issue appears not to have been empirically examined, particularly in emerging market economies. This gap in research highlights the need for verification to determine if fair value accounting indeed has the potential to create pro-cyclical effects in an economy. It is also argued that valuation under this accounting approach may exacerbate downward trends in asset prices and investor confidence. In such cases, entities might be forced to sell assets to comply with regulatory capital requirements, leading to persistent downward pressure on asset pricing (Simko, 2015). The debate on fair value accounting's role in pro-cyclicality continues, partly due to the global financial crisis of 2008.

Bart et al. (2017) suggested before the crisis that a mixed-measurement accounting system, where fair value accounting is selectively applied, could lead to negative growth and increased volatility in earnings compared to historical cost accounting. In the literature on fair value accounting, two perspectives emerge: the first examines the cause-and-effect relationship in economics, which is crucial for understanding financial reporting quality; the second considers fair value accounting as a proactive approach that provides early warnings of financial crises, potentially prompting timely and effective corporate decisions. Thus, applying fair value accounting could potentially reduce the severity of a crisis's effect on a firm's financial statements (Laux & Leuz, 2017). This study focuses on how fair value accounting is expected to affect earnings quality in the Nigerian banking sector. Previous studies have largely been conducted in foreign contexts, revealing a need to adapt the concept to the Nigerian setting. Consequently, this study aims to examine the effect of fair value accounting on earnings quality among selected Deposit Money Banks in Nigeria.

1.2 Hypotheses

For the purpose of this study, the following hypotheses have been proposed:

HO^1: Fair value Premium on 'Net Operating income" has no significant effect on earnings quality of Banks in Nigeria.

HO^2: Fair value Premium on "Other Comprehensive income" does not significantly affect earnings quality of Banks in Nigeria.

HO^3: Fair Value Premium on "Total Assets" does not significantly affect earnings qualityof Banks in Nigeria.

HO^4: Fair Value Premium on "Leverage" has no significant effect on earnings quality of Banksin Nigeria.

2.0 LITERATURE REVIEW

2.1 Fair Value Accounting (FVA)

Fair value represents the price agreed upon by a willing buyer and a willing seller in an arm's length transaction. It is a market-based measurement that is not specific to any particular entity. According to Ijeoma (2019), fair values provide "the most current and complete" estimates of

financial assets and liabilities, reflecting the amounts, timing, and riskiness of future cash flows related to the assets or obligations (IFRS 13, IFRS 9, and IAS 39). It represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Accurate measurement is crucial for assessing the reliability and relevance of reported details in financial statements, particularly concerning assets, liabilities, and equity. It has been argued that applying fair values to a commercial bank's portfolio of financial assets during times of crisis or market liquidity issues can be misleading and inappropriate (American Bankers Association, 2009; Ijeoma, 2019). Furthermore, the estimation of fair value (market-to-model) introduces opportunities for management judgment and intentional bias, which can compromise the quality of financial reporting (Nissim, 2016; Ryan, 2018).

Recently, there has been a global shift toward adopting International Financial Reporting Standards (IFRS) in the banking sector, particularly through the use of fair value accounting (IFRS 13). This trend is supported by international organizations such as the World Bank, the International Monetary Fund, and the Financial Stability Board (Magnan, 2019). The adoption of IFRS aims to establish a single set of high-quality global accounting standards (World Bank, 2017; FSB, 2015).

The fair value concept in banking arose from the introduction of accounting standards for financial instrument measurement (IFRS 9 and IFRS 7) in 2010, which replaced IAS 39 (Magnan, 2019). Nigeria, among 126 out of 150 profiled countries, has incorporated IFRS into the financial statements of its banking industry since 2015, replacing the local Generally Accepted Accounting Standards (GAAP) to improve comparability and facilitate fundraising both domestically and internationally (Ebirien & Nwanyanwu, 2017; Okpara & Iheanacho, 2020). While the adoption of IFRS 13 enhances the quality of financial statements in the banking sector through globalization, it also faces challenges such as inactive markets, skill shortages, government control, and weak regulatory environments, among others.

2.2 Earnings Quality

Earnings quality represents how effectively reported earnings indicate future corporate profits (Calscino et al., 2017). Investors and other users of financial statements regard earnings quality as crucial for capital market efficiency due to its role in reflecting the quality of earnings (Laux & Leuz, 2017). Thus, earnings quality (EQ) pertains to how well earnings represent the actual performance of the company (Dechow & Schrand, 2015). The attributes of high earnings quality include relevance, faithful representation, comparability, verifiability, timeliness, and understandability, as outlined in the conceptual framework for high earnings quality by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB, 2008). Earnings predictability refers to the ability of earnings to align with expectations. According to previous research by Lipe (2015) and Kousenidis et al. (2019), earnings predictability is associated with the adjustment of earnings shocks, where a higher variance signifies lower

predictability. Therefore, high values of predictability indicate less predictable earnings and lower earnings quality, whereas low values of predictability suggest more predictable earnings and higher earnings quality. More predictable earnings are considered to represent higher quality earnings. Earnings Quality is difficult to define precisely, and despite the existence of specific criteria for its evaluation, numerous factors influence the assessment of earnings quality. Previous literature has identified various attributes of reported income that are widely regarded as necessary characteristics of reported earnings (Francis et al., 2016; Baron et al., 2017). Pratt (2015) defines earnings quality as "the extent to which net income reported on the income statement diverges from true earnings."

Penman (2016) notes that earnings quality is determined not only by the quality of reported earnings but also by the quality of expected earnings. Schipper and Vincent (2015) characterize EQ as "the extent to which reported earnings faithfully represent Hicksian income," which encompasses "the change in net economic assets other than from transactions with owners." The challenge in defining earnings quality uniquely has led to a range of measures used in literature to evaluate it. There is no universally accepted significance of the concept or a commonly agreed-upon methodology for its assessment (Schipper and Vincent, 2015).

For instance, Dechow and Schrand (2015) describe a high-quality earnings number as one that accurately reflects a company's current operating performance and serves as a valuable summary measure for assessing firm value. Earnings Quality is a multidimensional concept with no unified definition and varies according to the perspective of each user. Consequently, it is challenging to quantify EQ, and current empirical studies often evaluate it by considering either a single attribute of earnings or various characteristics related to EQ (Francis et al., 2004; Dechow et al., 2015; Kousenidis et al., 2019).

2.3 Fair Value Accounting and Earnings Quality

The conceptual evaluation of fair value accounting literature revealed that, the shift from the traditional historical cost-based accounting model to a fair value; (market value) based accounting model has significant consequences on earnings. Every business entity is judged by its earnings as one of the most important parameters to measure the financial performance of the organization. The quality of earnings is an important benchmark to determine the ability to earn consistently in the future and to maintain quality, sustainability and growth in performance. It is important to state that, the judgment of any business corporate entity is on the assessment of its performance in relation to earnings (Mauro, Guido & Elisa, 2017). Earnings of business entities are cardinal indicators for measuring the corporate financial performance of business entities. One of the determinants of the future ability of an entity to maintain a: consistent quality and growth in performance is the earnings quality (Hodder et al, 2017). The transition of accounting measurement approach from historical cost method to fair value accounting method has great significance change on the properties of financial reporting. Although, up till date, no consensus has been empirically achieved as relate to the effect of fair value accounting approach on earnings quality of corporate entities. Probing the relationship between fair value accounting and earnings

and effectiveness of fair value measurement approach, it is important to empirically investigate how fair value accounting contributes to the achievement of the overall objective of financial reporting quality and decision relevance of information to various stakeholders (International Accounting Standard Board, 2010). Exposure to Fair Values is computed by income statement approach (Hodder et al, 2017). Large number of financial instruments (assets and liabilities) are reported by banks and these are recognized at fair value in accordance to IAS 39 and IFRS 9. Hence, reported net gains' (losses) at fair value through other comprehensive income is applied to measure the extent of fair values recognized in banks' income statements. Some debt instrument assets must be classified by fair value through other comprehensive income where fair value is not adopted. Net income from profit and loss statement is added to other comprehensive income (mostly fair value adjustments not allowed in profit and loss statement) and shown in the statement of comprehensive income.

The literal evaluation of the use of fair value accounting appeared well in an uninterrupted market environment, the relevance, integrity, and reliability of fair value measure reduces when markets Mechanisms do not run. In such condition, fair value is estimated using unscientifically methods which permits earnings manipulation and could result to a reduction of earnings quality: Estimation based on fair value accounting creates opportunity for managerial discretion and intended judgment capable of reducing the financial reporting quality of corporate entities (Niksim, 2016; Ijeoma, 2017; Hitz, 2017; Ryan, 2018). More so, hair value measurementapproach does not reflect the actual cash flows and underlying economic situation, as the valuationcontains noise attributed to market sensitivity other than economic fundamentals. A critical view on literature revealed that in an illiquid market environment, the processes of market prices to evaluate the assets and liabilities of entities may not be relevant since the circumstance prices doesnot always correlates to present discounted value of expected cash flows (Sodan, 2015). Also, priorstudies evidenced that the fair value measurement approach is less when based on unreliable observable inputs (Song, Thomas, & Yi, 2015, Simko, 2016; Nelson, 2016). In addition, a criticallook through on fair value literature revealed that the value relevance of fair value accounting is not same across time; the era of economic turmoil, fait value decreases due to uncertainty, information risk and illiquidity. Other studies that also flawed and demonstrate that fair value estimations are less significant when they are based on unreliable observable inputs are the studiesof (Song et al, 2015; Nelson, 2016; Simko, 2016).

However, contrary to the above assertions, some prior studies advanced, some reasons why fair value accounting approach could improve accounting quality (Lang et al., 2016; Ijeoma, 2017). Most prior studies on fair value accounting examined the reliability of fair value accounting Information for investors in capital markets, and the supporters of fair value accounting assert that market prices are the most and reliable significant appropriate measures of assets and liabilities of any given business entity (Barth, 2016; Ryan 2018). There exist empirical studies in fair value accounting literature that assert that, the application of fair value accounting has really improved the level of formativeness of the accounts, and that, fair value accounting offered reliable and relevant information regarding the volume, uncertainty and timing of future cash flows Barth,

2016; Hitz, 2017). One of the important statements in value relevance studies is that, fair value accounting has the inherent ability to predict an entity's cash flows in future realizations. That is, fair value valuation shows the current value of predictable future cash generation. Therefore, the relevance of fair value accounting can be drawn from its productive aptitude in assessing the expected entities' earnings and cash flows. More also, fair value valuation is a consistent measure of assets' values. (Barth, 2016). Specifically, the financial reporting system offinancial institutions are particularly exposed to fair value accounting, a number of studies investigated the predictive ability of fair value accounting in the banking sector performance. Particularly, as the statements of financial position of financial institutions are predominantly financial instruments which are mostly recognized at fair value. For instance, the performance literature on banking industry, Hill (2019) assert that amplified exposure to fair value accounting has an inherent ability to improve the financial reporting capacity of 'entities' earnings to predict future cash flows. However, other fair value prior studies equally cautioned the application of Hill (2019) empirical findings concerning the predictive aptitude of fair value; that, his findings cannotbe generalized due to the variations in reported fair values in other comprehensive income of an entity could be temporary within a high volatile market situation, therefore, the limitation make fair value accounting to lack the ability to amplify earnings capacity to expect future operating performance.

Still on fair value prediction, other prior empirical studies investigate and linked high ranks of earnings volatility with fair value accounting (Sun, Liu, & Cao, 2016; Barth, 2016; Hodder et al., 2017). Barth (2016) pointed out that financial statement volatility itself is not a sign of defective financial reporting, it is the evaluation based on the result of fair value accounting estimation that is defective, since the future cash flows of entities are uncertain. Estimation error on volatility tends to be lower if fair value is estimated using the prices that are available in active markets, otherwise called “mark to market”. And to the other hand, valuation error tends to be higher in situations when prices are not available in active markets, and when fair value is based on subjective valuation model (Mauro et al., 2017). Kirschenheiter and Melumad (2015), opined that, high quality earnings are more relevant, as it better signifies the future performance of an entity.

2.4 Theoretical Framework

This section examines theories employed by prior studies to establish the theoretical foundations of the study. For the purpose of this study, the core theory is the agency theory whichexplains the contractual relationship between preparers and user of earnings; reports. However, this study also employs the shareholder theory for the purpose of explaining the opportunistic tendencies created through the implementation of fair value accounting and how the quality of earnings is affected.

The Stakeholder’s theory focuses on issues concerning the stakeholders in a corporation. It stipulates that a corporate entity invariably seeks to provide a balance between the; varying interests of its diversestakeholders in order to ensure that each interest constituency receives some degree of attention and satisfaction (Abrams, 1951). The Stakeholder theory states that the board of directors owes a responsibility to a wider group of stakeholders other than just the

shareholders. A stakeholder in this case is any person or group which can affect/be affected by the actions of abusiness. It includes employees, customers, suppliers, creditors and even the wider community and competitors.

In this study, we investigate the relationship between fair value accounting and the earnings quality of banks. Fair value gains (losses) as reported by directors often exerts direct influence on earnings, and the interests of respective stakeholders are tied to the reported earnings. Therefore, directors' opportunistic tendency can only be downplayed if directors recognize that they owe a responsibility to a wider stakeholder group and are willing to implement such fair value adjustments with the aim of meeting the needs of all stakeholders corporate is viewed as a group of specialist appointed to convert the inputs of shareholders and other stakeholders such as employees, creditors and suppliers into forms that are saleable to customers, hence, earns profits and other forms of returns back to its shareholders.

Fair values accounting (ideally) satisfies the shareholder reporting objective by accounting for assets and liabilities in the balance sheet at fair value (to shareholders). The income statement then reports changes in fair value calculated in the balance sheet, and no separate income concept drives the income statement. Accordingly, the information supplied by fair value balance sheets and income statements has the following properties. These features apply to a balance sheet fully marked to fair value or to a subset of assets or liabilities so marked (like marketable securities).

This means that the directors are expected to apply their expertise in applying fair value accounting, not with the intention of meeting the interest of only one particular interest group (e.g. directors' compensation), but pursuing the interest of all stakeholders: because they represent the interest of all stakeholders. This is why this theory addresses the interests of the stakeholders and the need folk the directors to ensure reported earnings quality, as stakeholders often rely on this information for decision making. When earnings quality is negatively influenced by directors' opportunistic theory, the objective of the stakeholders' theory is defeated because only the interest of a particular group of stakeholders is met.

2.5 Empirical Studies

A number of empirical evidence has emerged on the impact of fair value accounting implementation on the quality of earnings in publicly listed banking and non-banking firms across the globe. Some studies have suggest that fair value accounting supports higher earnings quality, while others have not found any significant relationship between the application of fair value accounting and earnings quality of firms. These empirical studies are here discussed in paragraphs below; Olaoye and Ibukun-Falaye (2020) carried out an investigation on' the effect of fair value accounting on earnings quality of Nigeria commercial banks. To achieve this, the relationship' between fair values and earnings quality was examined to determine its nature, and the effect of fair value adoption on earnings quality. Eight banks were purposively selected for the study using the data on their annual financial statements for period, 2013-2023, for analyses. The dependent variable is earnings quality (EQ), proxied by predictability (PRED) of earnings; while the

independent variables and fair value through other comprehensive income (FVTOCI), net operating income (NOI), log of totalasset values (SIZE) and leverage (LEV). Employing ex-post facto research design using the paneldata regression and correlation tests for analyses. The results showed that all the independent variables (FVIOCI, NOI, SIZE and LEV) have significant relationship with the dependent variable(EQ). The F-statistic, 0.000070 is significant at 5% level of significance. The adjusted R2 indicatedthat about 49.61% variation in the EQ is as a result of FVTOCI, NOI, SIZE and LEV. The remaining 50.39% variation is due to variables not reflected in this model.

Xu, Carson, Fargher and Jiang, (2019) examined the association between far value measurements and banks discretionary loan loss provision and earnings quality. The study employed US regulatory financial data from 2009- to 2016 financial periods. A sample of U.S public banks were used for the purpose of the study and the results revealed evidence that fair value accounting especially through other comprehensive income are subject to more discretions regarding loan loss provisions. Furthermore, the overall results revealed that fair value accounting gives manager greater opportunities to manipulate earnings, thereby reducing earnings quality in the long run.

Ijeoma (2019) critically examined the controversial issues surrounding fair value accounting approach. The study extensively reviews relevant literature oh fair value accounting relevance and reliability to financial reporting. To achieve the objective the study, the study employed a library research methodology. Findings in this study revealed contentions issues such as: Fair value measurement and verification; financial instrument' measurement; 'cyclical effect of fair value accounting; Also, the study found that, the reliability and relevance of fair value accounting approach is tied to; market liquidity, presence of active 'market, and uninterrupted market environment; and finally, fair value accounting influences entities' earnings which invariably affect earnings quality negatively. Hill (2019) investigated fair value earnings as a predictor of future cash flows. The study emphasizes that these empirical results regarding predictive ability of values could not be generalized to more volatile market conditions and more subjective applications of fair value valuation. In addition, a number of empirical studies provide conflicting results, proving that changes in fair values reported in net income or other comprehensive income are transitory and donot increase earnings ability to predict future operating performance. The implication of this resultis that fair value related adjustments do not significantly increase reported earnings quality.

Jones and Smith (2018) have empirically examined the persistence of gains and losses in other comprehensive income and proved that these items are not transitory, but show a negative persistence. Higher volatility arises from the definition of fair value as the present values of a series of expected future cash flows. Thus, any subsequent adjustment in expectation of future cash flow will be automatically reflected in the change of fair value. Unlike the fair-value-based reporting, historical-cost-based reporting does not recognize changes in Values until the asset is sold. Empirical Studies almost exclusively prove that the move towards fair value accounting leads to increased earnings volatility.

Okolie, A. O. (2014), examines how the length of an auditor's tenure impacts their independence and the tendency of firms to engage in accrual-based earnings management. The findings emphasize the balance between familiarity and independence in maintaining audit quality.

Rhee, Choi and Ryu (2018) also analyzed the influence of firms' fair value system on earnings quality under IFRS. Korean firms are required to adopt IFRS in 2011. IFRS adoption was expected to increase value relevance of book value of equity and benefit information user's decision making. The study investigated whether the different level of fair value system among firms lead to the difference in earnings quality. Furthermore, we examine how each firm's fair value system affects earnings quality under IFRS. This Study finds following results. First, firms with, weak fair value system smooth income more frequently. Second, firms with weak fair value system experience small amount of positive profit and slight increase in net income compared to prior period more frequently. Third, firms with weak fair value system; make less timely loss recognition. Lastly, book value of equity and goodwill has low relative value relevance for weak fair value systemic firms, while both book value of equity and goodwill have incremental value relevance for firms with strong fair value evaluation system.

Mauro, Guido and Elisa (2017) carried out an investigation on fair value accounting an earnings quality in the banking sector with evidence from Europe. The study employed a number of cross-bolder European banks and secondary data were collected from the annual of the selected banks for a period of 10 years up to 2015, The study reveals that the use of fair value accounting measures gives managers the opportunistic tendency to manipulate earnings at their desired directions. Hence, the quality of reported earnings becomes questionable under fair value accounting. Furthermore, valuation error tends to be higher in situations when prices are not available inactive markets, and when fair value is based on subjective valuation model.

Paoloni, Paolucci and Menicucci (2017) also carried out a study on fair value accounting and earnings quality (EQ) in banking sector with evidence from Europe. This research investigates the influence of fair value accounting (FVA) on earnings quality (EQ) in European banking sector over the 2007 to 2016 period. As financial reporting system of banks is particularly exposed to F VA, we assume that FVA may produce significant effects on EQ for European banks. It can be expected that financial instruments' prices are not available in illiquid markets, so fair values are estimated by applying valuation models. The application of valuation models (that is, market to model) in estimating Fair Value gives managers the opportunity to manipulate values, and thus could bring through lower quality of earnings. This study develops a multidimensional concept of EQ, and measures it using a set of attributes as persistence, predictability, variability, and earnings smoothing.

Ebirien and Nwanyanwu (2017) research into earnings quality of firms in the Nigeria financial services spanning from 2011 to 2015. Specifically, the study examines the differential earnings quality of Commercial Banks and insurance companies listed on the Nigeria Stock Market. The study employed panel technique to gain data efficiency after subjecting the data collected to

normality test, multicollinearity test and Haussman test shows that random effect modelis preferred to fixed effect model. Earnings quality is found to vary to various stakeholders and predicts that DMBs exhibit higher EQ than the insurance companies. The work has successfully assessed earnings quality in isolation; it is therefore understandable that the conclusions were towards a comparative analysis of Commercial Banks with Insurance firms. It would have been quite interesting to link this assessment to fair value adoption in Nigeria.

Okolie, A. O., & Izedonmi, F. (2014), explores the relationship between audit quality (measured by auditor size and tenure) and earnings management in Nigerian firms. It highlights the role of independent audits in curbing opportunistic earnings manipulation, thus contributing to the credibility of financial reporting.

Ijeoma (2017) investigated the impact of fair value accounting, on corporate financial reporting in Nigeria. The study employed field survey method of data collection which involved the use of Questionnaire were 562 sample were used and was analyzed using Kruskal—Wallis rank sum test statistic. The study established that adoption of fair values provided investors with more relevant information than conventional reporting. However, it was noted that the present structure of the Nigeria capital market may obstruct the implementation of fair values. Adoption of full fair value for financial instruments was found to fulfill the aims or performance reporting. The study has concentrated on fair value accounting in isolation without a link to earnings quality but the discovery that the adoption of fair values is bedeviled by some challenges is remarkable especially in Nigerian context. Concluding that fair values fulfill the aims of performance reporting seems to be different from findings which highlight challenges.

3. Methodology

This study employs an ex-post facto research design, which is appropriate for examining the impact of fair value accounting on the earnings quality of quoted commercial banks in Nigeria. The ex-post facto design allows for the investigation of cause-and-effect relationships by analyzing existing data over a specific period. In this case, the study focuses on the period from 2013 to 2023. The design is suitable because it facilitates the use of secondary data, which has already been documented and reported in the annual financial statements of the selected banks. The study utilizes a quantitative approach to analyze the relationship between fair value premiums on various financial metrics (Net Operating Income, Other Comprehensive Income, Total Assets, and Leverage) and the earnings quality of the banks. Regression analysis will be used to test the hypotheses and draw conclusions on the effect of fair value accounting on earnings quality.

The model developed for this work is a regression model

wherein: $Y = f(X)$

Where Y = Earnings Quality (EQ)

X = Fair Values

And, Where,
EQ=PRED. $X = X^1, X^2, X^3\ X^4$
PRED = $\sqrt{\delta^2(V_{it})}$. The Square root of the error variance of Earnings.

$X^1 = FVTOCIt$, $X^2 = Size$, $X^3 = LEV$, $X^4 = NOI$

μ is the error term

Thus, $EQ^1t = \alpha^1 + \beta^1FVTOC^1t + \beta^2SIZE^1t + \beta^3LEV^1t + \beta^4NOI^1t + \mu$

Model specification involved selecting appropriate models to analyze the data based on the research hypotheses. The study used linear regression models to test the hypotheses and evaluate the effects of fair value accounting on earnings quality. Each model was designed to assess the impact of fair value premiums on specific financial metrics:
- Model 1: effect of Fair Value Premium on Other Comprehensive Income
- Model 2: effect of Fair Value Premium on Total Assets
- Model 3: effect of Fair Value Premium on Leverage
- Model 4: effect of Fair Value Premium on Net Operating Income

The models were specified to include control variables that account for other factors influencing earnings quality, ensuring that the effects attributed to fair value premiums are accurately isolated *(Model developed by author, 2024)*

4. Results

Table 1 presents the descriptive statistics of the data. It presents the mean, median, maximum, minimum, Standard deviation, Sum and sum square dev. for all the variables used in the model.

Data Analysis

Table 4.1: Description of Banks by Size, Leverage and Earnings Quality

	FVOCI	NOI	SIZE	LEV	EQ
Mean	0.075316	0.23456	21.03887	0.773346	0.115003
Maximum	0.963510	0.123457	22.17809	0.898680	0.140019
Minimum	-0.353990	0.634580	19.31964	0.005200	0.073275
Std. Dev.	0.212488	4.234310	0.775460	0.230744	0.011949
Probability	0.000000	0.0000010	0.116491	0.000000	0.000001
Sum	3.765820	2.456981	1051.944	38.66731	5.750138
Sum Sq. Dev.	2.212407	0.000180	29.46554	2.608892	0.006997
Observations	50	50	50	50	50

Source: Researchers' Summaries and Computation from Annual Reports of Selected Banks

Table 4.2: Diagnostic Test

Correlated Random Effects - Hausman Test

Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	11.131130	3	0.0110

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var (Diff.)	Prob.
FVOCI	-0.001996	-0.000247	0.000001	0.1469
LEV	-0.117014	-0.021556	0.004876	0.1716
SIZE	-0.009185	0.006118	0.000046	0.0236
NOI	-0.004189	0.017284	0.000280	0.0345

Source: Field Survey

Test of Hypothesis

The correctness of model specified was validated through diagnostic tests. The Hausman test probability showed 0.0110 which is lower than 0.05 specified; thus, we ran fixed effect.

Table 4.3: Regression results

Variable	**Coefficient -**	**Std. Error**	**t-Statistic**	**Prob.**
C	**0.398883**	**0.148939**	**2.678162**	**0.0110**
FVOCI	**-0.001996**	**0.006008**	**-0.332301**	**0.7415**
LEV	**-0.117014**	**0.070916**	**-1.650046**	**0.1074**
SIZE	**-0.009185**	**0.007609**	**-1.207135**	**0.2350**
NOI	**-0.128024**	**0.060280**	**-0.43320**	**0.8251**

5. Discussion

The dependent variable is earnings quality (EQ) while the independent variables are fair value Through Other Comprehensive Income (FVTOCI), NOI, Size of Asset (SIZE) and Leverage (LEV). The regression and correlation analyses results showed that all the independent variables (FVTOCI, SIZE, NOI and LEV) have significant but negative relationship with the dependent variable (EQ). The F-statistic of 0.000070 is significant at 5% level of significance. The R2 adjusted indicated that about 49.61% variation in the EQ is as a result of FVTOCI, SIZE, NOI and LEV. The remaining 50.39% variation is due to other variables not in this model.

The study examined the effect of fair value accounting on earnings quality of Commercial banks.

It employed a sample of eight (8) banks for periods of 10years (2013 – 2022) Purposive sampling method was used to select the sampled from the total population of 21 banks. The results revealed that all the independent variables (FVTOCI, SIZE, NOI, and LEV) have significant but negative relationships with the dependent variable EQ. The F- statistic of 0.000070 is significant at 5% level of significance. This implies that fair value has a negative effect on predictability of earnings and thus could be misleading if depended upon by investors for the purpose of investments. This contradicts the agency duties of directors who are expected to seek the best interests of the principals (shareholders) as explained by (Pauloni, et al., 2017).

6. Conclusions and Recommendations

The study concluded that that fair value has significance to Earnings Quality. When the intervening variables, Size and Leverage of the Banks are considered, earnings quality shows a negative relationship thus may not be a dependable basis for predicting earnings, hence making investment decision. The impact of fair value accounting on earnings quality is quite significant but negative. With the adoption of Fair Values, Earnings predictability of Nigerian Deposit Money Banks became quite high due to the variability of income. This impairs the earnings quality and thus affects the choices that stakeholders can make.

- **a.** It is recommending that management of banks should consider the state of the stock market and the economic climate while adopting fair value.
- **b.** Financial Statement regulators need to be forthcoming on conditions that favors the application of fair values in order not to impair earnings quality of banks.
- **c.** It is also recommended that the adoption of fair values in Nigerian Commercial Banks should be made to affect both the financial assets and the liabilities, especially the ones that connect to redemption of debt instruments issued by bank. Besides, the recent economic changes and shocks have told significantly on the earnings pattern of financial institutions in general and banks in particular, giving data on earnings with wide variation. Thus, adoption of fair value at such a period as this will distort the realities that accounting and financial reports are meant to portray.
- **d.** Financial statement regulators should be clear on what to do under such circumstances as this when stock market is quite unstable is challenged by liquidity.

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