

FAIR VALUE GAINS AND LOSSES AND PERCEPTIONS OF EARNINGS QUALITY: EVIDENCE FROM NIGERIAN DEPOSIT MONEY BANKS.

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ABSTRACT

The need to increase the quality of reported earnings in Nigeria has led to many efforts, including the adoption of International Financial Reporting Standards, which introduced fair value measurement for certain assets and liabilities. This study determined whether the perception of investors on the quality of earnings reported by banks is affected by the fair value gains and losses (FVGL) reported in income statements (NI) and other comprehensive income (OCI). The study used cross-sectional research design, and analysed data obtained over the period 2012 to 2016, from thirteen banks in Nigeria. Two hypotheses were tested using ordinary least square (OLS). The result revealed that investors' perception of earnings quality is not associated with the FVGL reported in NI and OCI. We attribute this result to learning curve and preponderance of unsophisticated investors in the Nigerian stock market. The paper recommends regular training and retraining on accounting for financial instruments for preparers and users of financial statements, auditors and regulators.

Keywords: Fair value gains and losses, financial instruments, perceptions of earnings quality, International Financial Reporting Standards

1. INTRODUCTION

All publicly listed firms in Nigeria mandatorily commenced the preparation of financial statements and financial reporting based on the International Financial Reporting Standards (IFRS) on January 1, 2012. The adoption of IFRS was recommended by the

World Bank whose investigations revealed deficiencies in the quality of financial reporting in Nigeria (World Bank, 2004, 2011). One of the prominent and predominant features of IFRS is the application of fair value accounting in the measurement of certain assets and liabilities. The use of fair value as a measurement basis has generated a great deal of controversy that remains unresolved to date. Proponents of fair value accounting argue that it better reflects the underlying economics of the firm, reduces earnings management and improves earnings quality (Ahmed & Takeda, 1995; Barth, 1994; Bhat, 2008; Bischof, Daske, & Gebhardt, 2011; Bratten, Causholli, & Khan, 2012; Eccher, Ramesh, & Thiagarajan, 1996; Goh, Li, Ng, & Owyong, 2015; Song, Thomas & Yi, 2010; Venkatachalam, 1996). On the other hand, opponents contend that fair value accounting results in volatility in earnings, procyclicality in earning, exacerbates managerial opportunism and therefore decreases earnings quality (Benston, 2008; Laux & Leuz, 2009; Ryan, 2008).

In response to the evolution of financial markets and the development of complex financial instruments, the International Accounting Standards Board (IASB) issued IAS 32, IAS 39, IFRS 7, IFRS 9 and IFRS 13 making fair value accounting the main measurement attribute of financial instruments. The use of fair value produces fair value gains and losses (FVGL). Bhat and Ryan (2015) state that FVGL are changes in fair value during periods that are not yet realized through cash received or paid. FVGL is the sum of realized and unrealized gains and losses on financial instruments (Barth, 1994; Venkatachalam, 1996). IFRS 9 and 13 require the FVGL to be reported in Income Statement (NI) and in Other Comprehensive Income (OCI). Reporting FVGL in NI and OCI should have implications for the properties of earnings, and fair value based earnings components could serve as a signal for unobservable managerial effort not fully captured by the traditional historical accounting measures of earnings (Manchiraju, Hamlen, Kross & Suk, 2015).

This study focuses on financial instruments in the banking sector because financial instruments are integral to banks' core operations and risk-management strategies and form substantial components of banks' statement of financial position. Financial instruments are characterized by two primary types of risk, market risk and credit risk requiring managerial discretion in estimating fair values. Managerial discretion in estimating fair values of financial instruments can be used opportunistically with consequences on earnings quality. Indeed several firms have suffered huge losses on their derivative positions causing concern among regulators and investors that firms may be using derivatives for speculative purposes (Manchiraju et al., 2015).

There is a plethora of research on the consequences of fair value accounting on earnings quality (Bratten et al., 2012; Dechow, Myers, and Shakespeare, 2010; Ryan, 2008; Song et al., 2010) but most of the studies focused on settings in which the use of fair value is voluntary and in developed capital markets – USA, Europe, Australia and China. Only a few of the studies examined the effect of fair value measurement on earnings quality. Thus there is scanty research on the impact of fair value measurement of financial instruments on earnings quality using data from deposit money banks (DMBs) in Nigeria.

Nigeria is a country that is plagued by institutional weakness and weakened regulatory enforcement (World Bank, 2004; 2011). The Nigerian stock market is shallow and bereft of large number of information intermediaries (analysts) relative to capital markets in the US and UK. Therefore, it is germane to ascertain what quality of earnings signals is conveyed to the market following the inclusion of FVGL in earnings. The objective of this study is to determine whether investors' perception of earnings quality of Nigerian listed DMBs is associated with FVGL reported in NI and OCI..

Analyses of 65 firm-year observations from a sample of 13 DMBs from 2012 to 2016, revealed that investors' perception of earnings quality of listed DMBs is not associated with the FVGL of financial instruments reported in NI and OCI. The result is of significance to the regulators, standard setters, users and preparers of financial statements. The study provides a more recent assessment of one of the consequences of the adoption of IFRS with respect to financial instrument on earnings quality in an emerging economy. The result should guide the regulators to evolve policies to improve understanding of IFRS and in particular fair value accounting for financial instruments.

The rest of the paper is organized as follows: Section 2 presents a literature review and develops the hypotheses. This is followed by the methodology in Section 3. The empirical findings and discussions are in Section 4 while the conclusion is in Section 5.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Banks are financial intermediaries, mobilizing funds from the surplus units for onward lending to the deficit units and providing platforms for payments. With increased competition and in the search for higher returns, banks expanded their traditional banking activities into investment banking and trading in securities. This expansion involves financial instruments. Prior to 2012, the defunct Nigerian Accounting Standards Board did not issue any specific accounting standards to regulate financial instruments' recognition and measurement. From January 1, 2012, firms listed on the Nigerian Stock Exchange mandatorily began to report according to IFRS. One of the prominent and predominant features of IFRS is the use of fair values for measurement. IFRS 13 defines fair value as the price at which an asset can be sold or liability paid for or settled between market participants in an orderly transaction at the measurement date. IAS 32 defines financial instrument as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Examples of financial instruments according to IAS 32 as cited in Mirza and Holt (2011) include: cash; an equity instrument of another equity; a contractual right to receive cash or another financial asset from another equity or to exchange financial assets or liabilities with another equity under conditions that are potentially favourable to the entity; a contract that may or will be settled in the entity's own equity instrument and is not classified as an equity instrument of the entity; payables, loans from other entities; issued bonds; obligations to deliver own shares worth at a fixed amount of cash.

Proponents of fair value contend that fair value allows firm to better reflect the underlying economics of the firm. It is argued that since fair value utilizes up to date market values it will enhance earnings quality. It is also argued that fair value accounting restricts accounting choices open to managers and therefore would improve earnings

quality. However, opponents of fair value counter the arguments and claim that market inputs might not be available for all financial instruments especially in inactive and inefficient markets thereby necessitating the use of internally generated inputs. This clearly affords managers discretion in choice of inputs which can lead to opportunistic earnings management practices and consequently lower the quality of reported earnings. Fair value accounting is also criticized for amplifying earnings volatility (Hodder, Hopkins and Wahlen, 2006; Maganan, 2009; Sun, Liu, and Cao, 2011). Barth, Landsman, and Wahlen (1995) identified three possible sources of financial statements volatility that are associated with fair values: inherent volatility, estimation error volatility and mixed measurement volatility. Inherent volatility is related to the characteristics of the assets or liabilities being measured. Estimation error volatility results from imperfect measurements because of valuation inputs used. Third, "artificial" source of volatility is mixed-measurement volatility attributable to the mixed measurement model.

The use of fair value for measuring financial instruments produces FVGL. Accounting for financial instruments during the study period is guided by IAS 32, 39, IFRS 7, 9 and 13. IFRS 9 permits a mixed measurement model for financial instruments whereby some financial assets are measured at amortized cost while others are measured at fair value. The choice of the models is based on the business model of the reporting entity and the cash flows characteristics of the financial instrument.

IFRS 13 requires that fair values of financial instruments be measured based on sources of inputs (Fair Value Hierarchy) which are Level 1, Level 2 and Level 3 respectively. At Level 1, the sources of inputs are quoted market prices (unadjusted) in active markets for identical instruments. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis (United Bank for Africa Plc, 2015). For Level 2 measurements, all significant inputs are directly or indirectly observable from market data for similar or identical financial instruments. For Level 3, all the significant fair value inputs are not from observable data but from the entity-specific estimates or entity generated estimates.

It is argued fair values' ability to predict future earnings is constrained in a financial reporting environment. In inactive or inefficient markets, valuation techniques are based predominantly on Level 3 inputs. Song et al. (2010) analyzed the value relevance of fair values (earnings quality) based on the source of inputs used to estimate fair values. They find that fair value assets based on Level 3 fair value hierarchy are priced less than fair value assets which derive their fair value estimates from Level 1 fair value hierarchy.

The accounting standards stipulate that FVGL on financial instruments be reported in NI and in OCI. Financial instruments are measured initially at fair value but subsequent measurement can be either at fair value or amortised cost depending on the classification of the financial instruments. Financial instruments are classified as held-to-maturity (HTM), at fair value through profit or loss (FVTP), and available-for-sale (AFS). HTM financial instruments are financial instruments with fixed determinable payments and

fixed maturities that management has both the positive intent and ability to hold to maturity. HTM is measured at amortised cost but if classified as AFS, it is designated as FVTP and the difference between amortised cost and fair value is accounted for in OCI. Financial instruments classified as FVTP on initial recognition consist of two sub categories, namely: Financial instruments held for trading (HFT) and financial instruments designated at fair value through profit or loss (FVTP). HFT financial instruments are acquired or incurred principally for the purpose of selling in the short-term or as part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit making. All FVGL on HFT financial instruments are recognized in the NI. Generally, AFS financial instruments are those financial instruments that are not designated as HTM or HFT or FVTP and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Subsequent to initial measurement, AFS financial instruments are carried at fair value and all FVGL are recognized directly in fair value reserve in OCI until the financial instrument is derecognized or impaired. When AFS financial instrument is disposed of, the fair value adjustments accumulated in OCI are recognized in the NI. This study focuses on only financial instruments measured at initial recognition and subsequent to initial recognition at fair value.

FVGL has attracted a great amount of research since it constitutes an important element of bank risk and profitability (Hodder et al, 2006). Furthermore, earnings are oriented towards the interest of shareholders who are an important group of financial statement users (Brown, 1999 as cited in Deegan & Unerman, 2011).

Based on 202 US commercial banks which recognize FVGL on virtually all financial instruments over the period 1996 to 2004, Hodder et al (2006) examined properties of GAAP net income, GAAP comprehensive income, and full fair value income to determine which accounting income measure best reflects firm risk. They found that investors regard the full fair value income as the measure that better reflects a firm's underlying economic risk. This implies that fair value income enhances the earnings quality of the sample firms.

Barth (1994) empirically examined the extent and determinants of the value-relevance of fair values and the returns-relevance of FVGL for financial instruments. The study reported that unrealized securities gains and losses are not priced by the market as a component of earnings. This is at variance with Hodder et al (2006) and the result may be driven by changes in the macro-economic environment of the US in the two distinct sample periods.

Barth, Beaver, and Wolfson (1990) investigated the realized securities gains and losses components of bank earnings and found that the multiple on realized securities gains and losses generally are insignificantly different from zero. They interpret this result as suggesting that the market does not value realized securities gains and losses because they view the realized securities gains and losses as transitory, lacking timeliness and tainted by managerial opportunism.

Using 854 firm-quarters observations from US banks, financial firms and insurance firms for the period 2009 to 2012, Chung, Lobo and Owyong (2017) examined the economic implications of fair value liability gains and losses. They documented a positive relationship between a firm's fair value liability gains and losses and current period stock returns, and a negative association with future returns, suggesting that investors misprice this earnings component.

Kanagaretnam, Mathieu, and Shehata (2009) studied 228 firm-year observations derived from 75 Canadian firms cross listed on the US Stock Exchanges from 1998 to 2003, focusing on the capital market valuation of the change in the balance of unrealized holding gains and losses on available-for-sale securities, the change in the fair value of cash flow hedges, and the change in cumulative foreign currency translation adjustment. They provide evidence that these three items included as components of OCI are significantly associated with price and market returns.

Dhaliwal, Subramanyam, and Trezevant (1999) investigated the predictive ability of NI and OCI using data based on a US sample consisting of 11,425 firm-years and documented that fair value changes in marketable securities improve the association between income and returns.

The effect of FVGL on earnings quality was also studied by Goncharov and Hodgson (2008). They empirically confirmed that unrealized fair value gains (losses) in OCI reduce the level of earnings conservatism. Earnings conservatism is one of the proxies of earnings quality (Francis, LaFond, Olsson & Schipper, 2004).

Soda (2015) hypothesized that banks and companies in Eastern Europe with high proportion of FVGL in the income statement will have lower level of aggregate earnings quality. He provided evidence showing that FVGL is negatively related with aggregate earnings quality for both companies and banks. This suggests that FVGL affects earnings quality negatively. The study by Soda (2015) is closely related to our study. While Soda (2015) examined the effect of FVGL on aggregate earnings quality, the current paper assesses the perception of the investors with respect to the earnings quality following the recognition of FVGL on financial instruments in the NI and OCI. While this study tested the FVGL in both the NI and OCI, Soda (2015) did not. Furthermore while Soda (2015) constructed aggregate earnings quality, this study uses the earnings response coefficient to capture the perception of investors concerning earnings quality.

One of the criticisms of fair value accounting is that it affords managers earnings management opportunities. To this end, Dechow, Myers and Shakespeare (2010) examined fair value and gains from securitization and reported that managers use the discretion inherent in fair value accounting rules to report larger gains thereby influencing the quality of reported earnings.

Prior studies of earnings quality provide evidence that institutional differences affect the properties of earnings (Ball, Robin, and Wu, 2003, La Porta, 1998, Nobes 1998). ***Fiechter and Novotny-Farkas (2017)*** used a global sample of IFRS banks and provided evidence that institutional differences across countries (e.g., information environment or

market sophistication) affect investors' ability to process and impound fair value information in their valuation.

Nigeria is a country that is plagued by institutional weakness, weakened regulatory enforcement and insufficient information intermediaries (World Bank, 2004; 2011). The Nigerian stock market is shallow and bereft of large number of information intermediaries (analysts) relative to exchanges in the US and UK. The country's experience with IFRS is nascent and investors generally are unsophisticated. Accounting for financial instruments generally is more complicated and complex than non-financial instruments and demands expertise. Johnson (2007) provided a survey evidence suggesting that even some auditors appear not to fully understand the application of fair value accounting rules. It follows that financial statement users might likely have difficulty evaluating the reasonableness of reported FVGL especially that of DMBs as the operations of DMBs are highly opaque (Levine, 2004) given the opportunistic behavior of managers. Lipe (2002) reported that FVGL is very confusing to the market because firms report a gain when its financial strength deteriorates and a loss when its financial strength increases. This misinterpretation could be worse for less sophisticated participants. The above submissions lead to the following hypotheses of this study:

- H₁: Investors' perception of earnings quality of Nigerian listed DMBs is not associated with the FVGL reported in NI.
- H₂: Investors' perception of earnings quality of Nigerian listed DMBs is not associated with the FVGL reported in OCI.

3. METHODOLOGY

3.1 Data.

The study obtained price data and market returns from the Nigerian Stock Exchange. FVGL, EPS and corporate governance data are derived from the annual reports of DMBs obtained from the Library of the Nigerian Stock Exchange in Port Harcourt.

3.2 Population and sample.

The population of this study comprises all the DMBs listed on the Nigerian Stock Exchange between 2012 and 2016. The Fact Book of the Nigerian Stock showed that fifteen DMBs were listed on the Nigerian Stock Exchange at December 31, 2016. Of the fifteen DMBs, two DMBs have incomplete data and were consequently deleted thereby giving a sample of thirteen DMBs that yields 65 firm-year observations.

3.3 Empirical Model.

This study follows Ghosh and Moon (2005) and Barber, Krishman, and Zhang (2012) who used the earnings response coefficient as a proxy for investors' perception of earnings quality. The study employed the following regressions to analyze whether investors' perception of the earnings quality of the Nigerian listed DMBs is affected by the FVGL of financial instruments.

Accordingly the empirical model is stated in explicit form thus:

$$CAR_{it} = \Psi_0 + \Psi_1 EPS_{it} + \Psi_2 ? EPS_{it} + \Psi_3 FVGLN_{it} + \Psi_4 EPS * FVGLN_{it} + \Psi_5 ? EPS * FVGLN_{it} + \Psi_6 BETA_{it} + \Psi_7 SZE_{it} + \Psi_8 LEV_{it} + \Psi_9 GROWTH_{it} + \Psi_{10} RCAD_{it} + \Psi_{11} AGE_{it} + \Psi_{12} ACEF_{it} + \varepsilon_i \dots\dots\dots(1)$$

$$CAR_{it} = \Psi_0 + \Psi_1 EPS_{it} + \Psi_2 ? EPS_{it} + \Psi_3 FVGLC_{it} + \Psi_4 EPS * FVGLC_{it} + \Psi_5 ? EPS * FVGLC_{it} + \Psi_6 BETA_{it} + \Psi_7 SZE_{it} + \Psi_8 LEV_{it} + \Psi_9 GROWTH_{it} + \Psi_{10} RCAD_{it} + \Psi_{11} AGE_{it} + \Psi_{12} ACEF_{it} + \varepsilon_i \dots\dots\dots(2)$$

Where for DMB i at year t:

- CAR = Cumulative abnormal stock return. Based on the market model, CAR is obtained by accumulating abnormal security returns over the 15-month period beginning 12 months prior to the fiscal year-end and ending three months after the end of the fiscal year.
- EPS = Earnings per share as in the financial statements.
- ? EPS = Change in EPS ie EPSt – EPSt-1.
- FVGLN = Fair value gains and losses on financial instruments reported in Income Statement scaled by market value of equity.
- FVGLC = Fair value gains and losses on financial instruments reported in Other Comprehensive Income scaled by market value of equity.
- EPS*FVGLN = Interaction between EPS and FVGLN.
- ? EPS*FVGLN = Interaction between ? EPS and FVGLN.
- EPS*FVGLC = Interaction between EPS and FVGLC.
- ? EPS*FVGLC = Interaction between ? EPS and FVGLC.
- BETA = Beta. We estimate each DMB’s Beta for each year from the market model using a DBM’s security return data and the return on the NSE equally weighted market portfolio over the 60 months ending three months after the fiscal year end.
- SZE = Size computed as natural logarithm of total assets at fiscal year end
- LEV = Leverage, computed as total liabilities divided by total assets.
- GROWTH = Growth opportunities calculated as change in gross earnings divided by lagged gross earnings.
- RCAD = Total regulatory capital adequacy ratio.
- AGE = Natural logarithm of Age of DMB; age computed as the number of days since the DMB was listed on the Nigerian Stock Exchange .
- ACEF = Index of audit committee effectiveness. Following extant literature on the factors influencing audit committee effectiveness we selected the following characteristics: Audit committee frequency of meeting to proxy diligence, Number of independent directors on the Audit committee to proxy independence, Number of professional accountants on the audit committee to proxy accounting expertise and financial literacy and the number of women on the committee to proxy gender diversity. Each characteristics except independence is scored on a scale of 1 to 4. Independence is scored 1 for each

independent director subject to a maximum of 2. The individual scores of each characteristics are summed up for each DMB and divided by the overall expected total of 14 to obtain the ratio of audit committee effectiveness.

e_i = Error term.
 $\beta_0, \dots, \beta_{12}$ = Regression parameters.

In the above regressions, the earnings response coefficient (ERC), i.e. the sum of the coefficients of earnings and earnings level changes ($\beta_1 + \beta_2$) is the proxy for markets' perceptions of earnings quality. However, the variable of interest is the sum of coefficient on $\beta_4 \text{EPS} * \text{FVGLN}_{it} + \beta_5 \text{EPS} * \text{FVGLN}_{it}$ ($\beta_4 + \beta_5$) in Equation (1) and $\beta_4 \text{EPS} * \text{FVGLC}_{it} + \beta_5 \text{EPS} * \text{FVGLC}_{it}$ ($\beta_4 + \beta_5$) in Equation (2) respectively. If investors perceive earnings quality to be associated with the FVGL in NI and OCI respectively, $\beta_4 + \beta_5$ in each case is expected to be positive and significantly different from zero.

The paper includes several control variables which prior studies found to be other determinants of ERCs. BETA is used to proxy for the riskiness of earnings and systematic risk and is negatively related to ERC (Collins & Kothari, 1989; Easton & Zmijewski, 1989). Size (SZE) is included to control for political cost. The Political Cost hypothesis holds that large firms are likely to manage earnings to deflect political attention (Han & Wang, 1998; Watts & Zimmerman, 1986). A negative sign is expected.

Leverage (LEV) also captures the riskiness of earnings and is included in the regression to minimize the potential effect of model misspecification. It is documented that firms with high leverage are likely to exploit the accounting rules to avoid debt covenant violation (DeFond & Jiambalvo, 1994). Consistent with Dhaliwal, Lee, and Fargher, (1991), leverage is predicted to have a negative sign with CAR. Collins and Kothari (1989) documented that ERCs are increasing in growth opportunities (GROWTH). Goh et al (2015) provided empirical evidence that capital adequacy influences investors' assessments of banks' reported fair value estimates, justifying the inclusion of capital adequacy ratio in the regressions (RCAD). The inclusion of age (AGE) is informed by evidence that older firms are more likely to be more stable and have less information asymmetry problem leading to a positive association with CAR.

The audit committee oversees financial reporting and prior studies document that the audit committee effectiveness depends on its characteristics which the market values in assessing earnings quality (Carcello & Neal 2003; DeFond, Hann, & Hu, 2005; Krishnan, 2005; Vafeas, 2005). A positive coefficient of audit committee effectiveness (ACEF) suggests the audit committee is effective but a negative sign suggests otherwise.

4. RESULTS AND DISCUSSION

Table 1 reports the descriptive statistics of the variables used in the study, The average cumulative abnormal returns is positive (7.02). The standard deviation of 52.37 suggests high variability in the CAR of the DMBs. The earnings per share ranges from (N0.59) to N4.67 with a mean of N1.35. The negative EPS of N0.59 suggests that some DMBs

incurred losses during the period studied. The mean value of FVGL in the NI is 10% compared to less than 1% reported in OCI. The mean regulatory capital adequacy ratio of 17% suggests most DMBs exceed the minimum of 15% prescribed by the Central Bank of Nigeria and are therefore sound.

Table 1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
car	65	7.024696	52.36947	-116.1361	207.2762
Eps	65	1.354	1.231948	-.59	4.67
? eps	65	.4421538	1.762265	-1.92	12.9
fvgl	65	.1030188	.1949503	-.0787111	1.151359
fvglc	65	.0008296	.0919917	-.5702259	.1960717
Beta	65	1.380593	.7069091	.30503	4.67604
sz	65	20.68255	1.695904	13.75115	22.27927
lev	65	.8766688	.104057	.767	1.6375
growth	65	.1920466	.288293	-.64584	1.60079
rcad	65	.1718446	.1441923	-.4698	.809
age	65	8.731296	.6272759	7.8501	9.73365
acef	65	.3519231	.1107994	.125	.5625

Source: Authors' analyses of annual report data

Table 1 shows a mean of 35% for the audit committee effectiveness of the DMBs suggesting a majority of the audit committees are not effective. That majority of the audit committees are ineffective is in agreement with the submission of prior studies (Chukwu & Nwabochi, 2019; Owolabi & Ogbechi, 2010) that most audit committees in Nigeria neither have the commitment to watch for details in financial reporting nor the skill to design and implement a strong internal control system to prevent poor reporting.

In conducting the study, we performed some regression diagnostics which included a test for outliers, normality, linearity, multicollinearity, homoscedasticity, and serial correlation using Stata 12. Based on the results we transformed the data and reported the regression results based on standard robust errors. We scaled FVGL by market value of equity at fiscal year-end, reported CAR, earnings and earnings changes on per share basis and computed the natural logarithms of total assets for "size".

Table 2 presents the correlation matrix. Table 2 shows that all the variables except size, leverage and regulatory capital adequacy ratio are positively but insignificantly correlated with CAR. Beta is negatively and significantly correlated with earnings but positively and significantly correlated with FVGL reported in Income Statement. Size exhibits positive correlation with earnings at 5% level of significance thereby providing preliminary support for the political cost hypothesis.

Table 2 Correlation Matrix

	car	Eps	Δeps	fvghn	fvglc	Beta	Sze	Lev	growth	rcad	age	acef
car	1											
eps	0.02	1										
Δeps	0.13	0.08	1									
fvghn	0.03	-0.14	-0.11	1								
fvglc	0.15	0.11	0.00	-0.04	1							
beta	0.14	-0.36*	0.02	0.59*	0.04	1						
sze	-0.15	0.24*	0.06	0.04	-0.04	-0.05	1					
lev	-0.02	0.08	-0.10	-0.07	-0.04	-0.18	-0.02	1				
growth	0.22	0.12	0.17	-0.12	-0.06	-0.16	0.25*	-0.26*	1			
rcad	-0.14	0.25*	0.09	-0.5*	0.24	-0.5*	0.08	0.01	0.08	1		
age	0.05	0.00	0.12	-0.07	-0.01	-0.12*	0.27	0.02	0.02	-0.05	1	
acef	-0.21	-0.07	-0.18	0.09	-0.12	-0.05	0.00	-0.05	0.08	-0.19	0.09	1

*Correlation is significant at 5% level

Regulatory capital adequacy ratio indicates a negative correlation with both FVGL in Income Statement and Beta at 5% level of significance. The significant association in the correlational analysis suggests multicollinearity is a serious concern. However, the values of the variance inflation factor (VIF) as shown in Table 3 indicate multicollinearity poses no threat to the regression results because the values are below the threshold of 10 (Hair, Black, Babin, and Anderson, 2010).

Table 3 reports the results of estimating equation 1 and equation 2. The coefficient of determination (R²) is 27% in Model 1 and 28% in Model 2. This shows that the independent variables jointly explain 27% and 28% variation in CAR in Model 1 and Model 2 respectively. The F statistics in Table 4 reveal that the models have excellent fit (p-value = 0.019) for Model 1 and (p-value = 0.005) for Model 2.

Table 3 also shows that reported earnings and the earnings level change are different from zero and positively associated with returns (CAR) in Model 1 but the association is not significant (p-value = 0.623 for EPS and 0.918 for ΔEPS). The result is in consonance with prior studies on earnings-return association. The sum of coefficients of earnings and earnings level change (ERC) is 3.250 and insignificant in Model 1 (p-value = 0.696). Though insignificant, the positive direction of ERC shows that investors perceive earnings as informative in their investment decision.

Table 3 Regression Results

Variable		Model 1				Model 2			
		Coef	SE	p-value	VIF	coef	SE	p-value	VIF
Eps	Ψ_1	2.735	5.537	0.623	1.20	4.027	5.153	0.438	1.17
Δ eps	Ψ_2	.5156	4.967	0.918	2.30	1.304	5.338	0.808	2.40
	$\Psi_1 + \Psi_2$	3.250	10.50	0.696		5.332	10.49	0.562	
Fvglm	Ψ_3	-51.56	57.59	0.375	2.97				
eps*fvgln	Ψ_4	47.183	58.12	0.421	1.52				
Δ eps*fvgln	Ψ_5	48.447	100.8	0.633	1.45				
	$\Psi_4 + \Psi_5$	95.630	158.97	0.535					
Fvglc						111.4	133.4	0.407	2.98
eps*fvglc						60.26	179.5	0.738	2.03
Δ eps*fvglc						302.7	615.0	0.625	1.32
Erc						363.03	794.5	0.645	
Beta	Ψ_6	21.514	12.68	0.096	2.48	10.50	10.25	0.311	1.84
Size	Ψ_7	-9.069	3.510	0.013	1.28	-9.15	3.708	0.017	1.28
Lev	Ψ_8	47.519	38.57	0.223	1.18	39.40	36.29	0.283	1.17
Growth	Ψ_9	62.752	24.26	0.013	1.28	67.12	24.72	0.009	1.28
Rcad	Ψ_{10}	-50.35	52.48	0.342	1.69	-73.66	54.23	0.180	1.83
Age	Ψ_{12}	11.217	11.88	0.350	1.22	8.588	10.83	0.432	1.36
Acef	Ψ_{13}	-91.17	76.27	0.237	1.28	-98.77	77.01	0.205	1.26
Constant	Ψ_0	50.065	115.12	0.665		99.67	106.4	0.354	
No of obs		65				65			
Prob > F		0.0187				0.005			
R-squared		0.2703				0.281			

Source: Results of data analyses

From Table 3, it is revealed that FVGLN is negatively (-51.56) and insignificantly associated with CAR (p-value = 0.375) suggesting that FVGL reported in NI does not provide information incremental to that explained by EPS and ? EPS.

Our interest is the sign and magnitude of the coefficients of EPS*FVGLN and ? EPS*FVGLN in Model 1 and EPS*FVGLC and ? EPS*FVGLC in Model 2. The coefficients of EPS*FVGLN and ? EPS*FVGLN are positive and different from zero (47.183) and (48.447) respectively. The relationship with CAR is statistically insignificant (p-value = 0.421 for ? EPS*FVGLN and 0.633 for ? EPS*FVGLN. The sum of the coefficients on ? E*FVGLN and ? E*FVGLN (i.e. ERC) in Model 1 is positive and different from zero (95.63) but this is not significant (p-value = 0.535). The result indicates that investors' perception of earnings quality is not associated with the FVGLs reported in income statement. In other words, FVGL reported in income statements do not affect investors' perception of earnings quality reported by DMBs in Nigeria. Thus the result provides support for H1.

The FVGL reported in OCI is positive and different from zero (111.4) but insignificant (p-value = 0.407). Similarly the coefficient on the interactive term E*FVGLC is positive and different from zero (60.26) and insignificant (p-value = 0.738). In the same fashion, the coefficient on ? E*FVGLC is positive and different from zero (302.77) and insignificant (p-value = 0.623). The results show that FVGL reported in OCI exhibits

insignificant incremental explanation in variations in returns (CAR). The coefficient of the sum of $\text{EPS} \cdot \text{FVGLC}$ and $\beta \cdot \text{EPS} \cdot \text{FVGLC}$, our proxy for investors' perception of earnings quality (ERC) is positive and different from zero (363.0345) but insignificant (0.6456). This implies that FVGLs on financial instruments reported in OCI do not affect investors' perception of the earnings quality of listed DMBs. In other words, bank investors in Nigeria do not perceive that the earnings quality of listed DMBs is affected by the FVGL on financial instruments reported in OCI Thus H2 is sustained.

The control variables in Table 3 that indicate statistical significance are beta, size and growth opportunities. Beta is positively and significantly related to CAR in Model 1 (p-value = 0.09) but is not significant in Model 2 (p-value = 0.311). As beta increases by 1%, CAR increases by 215% in Model 1 and by 105% in Model 2. This is inconsistent with the findings of Collins and Kothari (1989). A 1% increase in the size of DMB leads to a 90% decline CAR in both Models and this is at 1% level of significance. This suggests that DMBs are conscious of the political scrutiny their reported earnings; and this is consistent with the Political Cost Hypothesis (Han and Wang, 1998; Watts & Zimmerman, 1986). Growth is positively associated with CAR with p-value < 0.01 in both Models. This confirms the evidence in Collins and Kothari (1989) who documented that ERCs are increasing in growth opportunities.

5. CONCLUSION AND RECOMMENDATIONS

This paper examines whether investors' perception of earnings quality of Nigerian listed DMBs is affected by the FVGL reported in NI and OCI as prescribed by IFRS 9. Evidence shows that investors' perception of earnings quality of Nigerian listed DMBs is not influenced by FVGL reported in NI and OCI. We attribute this result to the learning curve, preponderance of unsophisticated investors, persistent accounting scandals in the Nigerian banking industry occasioned by weak institutional framework which fosters managerial opportunism, insufficient information intermediaries and the shallow stock market. It is possible that with time, consistent with the law of effect theory, the opaque nature of the banking industry will constrain investors to consider all available information in assessing the earning quality of banks in Nigeria. In view of the above findings, it is recommended that training and retraining in respect of accounting for financial instruments be conducted regularly for preparers and users of financial statements, auditors and regulators. The stock market should be deepened and regulators should be strengthened to enforce relevant laws.

A limitation of this study is our proxy for investor perception (ERC). Though ERC is widely used in earnings-return associations, it is considered noisy. Its widespread and long term use as a model for identifying how the market responds differently to the information on earnings, justifies our use of ERC in this study. Another limitation is the relatively small sample size due to data constraints resulting from relatively recent IFRS experience and our focus on a single industry. Further research may use other measures of investors' perception and a wider sample base which may include insurance firms.

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