THE EFFECT OF INCOME APPROACH AND CORPORATE PROFITABILITY OF LISTED CEMENT FIRMS IN NIGERIA

BANI BARI-AGARA
Department of Accounting, Faculty of Management Sciences
Ignatius Ajuru University of Education, Rumuolumeni
Port Harcourt, Rivers State, Nigeria
banibaiagara@gmail.com

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URANGYORK LAMBERT DIMKPA
Department of Accounting, Faculty of Management Sciences
Ignatius Ajuru University of Education, Rumuolumeni
Port Harcourt, Rivers State, Nigeria
lamberturangawaji@gmail.com

Abstract
This study investigates the effect of the income approach to fair value measurement on the corporate profitability of listed cement firms in Nigeria. The study was anchored on Agency Theory, the research examines how the significant managerial discretion inherent in this Level 3 valuation method influences key profitability indicators: Return on Capital Employed (ROCE) and Return on Equity (ROE). Utilizing an ex-post-facto research design, secondary financial data from the annual reports of three leading cement firms (Dangote Cement Plc, BUA Cement Plc, and Lafarge Africa Plc) were analyzed over a five-year period. Regression analysis revealed a statistically significant and strong positive effect of the income approach on both ROCE (R = .946, p = 0.015) and ROE (R = .977, p = 0.004). The findings indicate that the forward-looking, cash-flow-based valuation of the income approach substantially enhances the relevance of reported profitability by aligning asset book values with their future income-generating potential. The study concludes that while this approach improves financial statement informativeness in Nigeria's capital-intensive cement sector, it necessitates stringent internal governance and enhanced regulatory disclosures to mitigate the agency risks associated with managerial judgment in fair value estimation. Consequently, the study recommended that firms adopt formalized valuation policies and that standard-setters provide sector-specific implementation guidance to ensure consistency and reliability in profitability reporting.
Keywords: Income Approach, Fair Value Measurement, Corporate Profitability, ROCE, ROE, Agency Theory, Cement Industry, Nigeria.

Introduction

Fair value measurement has become a central issue in modern financial reporting due to the increasing emphasis on International Financial Reporting Standards that promote the use of current values rather than historical cost for the valuation of assets and liabilities (Barth, 2021). Among the approaches applied in fair value assessment, the income approach has gained significant relevance because of its focus on the present value of expected future economic benefits associated with an asset. This makes it particularly useful for firms in asset intensive industries such as cement manufacturing, where long term investments, depreciation, and fluctuating replacement values affect both short term and long term financial performance (Damodaran, 2012). The income approach provides insight into the future earning potential of assets, which directly connects valuation practice to profitability indicators such as Return on Capital Employed and Return on Equity (Ross, Westerfield, and Jaffe, 2016).

Corporate profitability represents the capacity of a firm to generate returns from its resources. ROCE and ROE are critical indicators widely used to assess financial performance and to evaluate how efficiently a company employs its capital and equity base to yield profits (Pandey, 2015). In emerging economies such as Nigeria, the cement sector operates under conditions of exchange rate volatility, inflation, changes in input costs, and fluctuating market demand. These conditions make valuation decisions even more important because inaccurate valuation can distort reported profit levels and impact stakeholder decisions. Previous studies suggest that valuation methods may influence reported earnings and financial ratios by either overstating or understating asset values depending on the measurement basis adopted (Laux and Leuz, 2009).

Despite the relevance of fair value measurement, empirical studies reveal that its application in Nigeria is still evolving, and many firms struggle with the choice and implementation of valuation techniques. The income approach, in particular, requires credible estimates of future cash flows and discount rates, which introduces the risk of judgmental errors and managerial discretion (Thesing and Velte, 2021). These challenges raise questions about whether the income approach improves or distorts profitability assessments for firms in the cement industry. This article therefore examines the effect of the income approach on corporate profitability, focusing specifically on its influence on Return on Capital Employed and Return on Equity among listed cement firms in Nigeria.

Statement of the Problem

Profitability remains a central measure of financial performance in the cement industry, yet firms in Nigeria continue to face profitability pressures arising from inflation, exchange rate instability, and rising production costs. These challenges directly influence key indicators such as Return on Capital Employed and Return on Equity, which are essential for evaluating efficiency and investor value. With the adoption of fair value measurement under IFRS, the income approach has become an important valuation method because it is based on the present value of future cash flows. Although this should, in principle, enhance the relevance of financial information (Damodaran, 2012), its effectiveness depends heavily on managerial assumptions, discount rates, and projected cash flows. Literature indicates that these

elements introduce subjectivity and may distort profitability outcomes (Thesing and Velte, 2021). Empirical studies also reveal mixed evidence regarding whether the income approach improves or weakens profitability assessments in industries exposed to volatile market conditions. In Nigeria, the application of fair value measurement is still developing, and there is limited evidence on how income based valuation specifically affects ROCE and ROE of cement firms. This lack of clarity raises concerns about the reliability of profitability indicators generated under the income approach. Therefore, the problem this study addresses is the uncertain effect of the income approach on corporate profitability, particularly its influence on Return on Capital Employed and Return on Equity among listed cement firms in Nigeria.

Purpose of the Study

The primary aim of this study is to examine the effect of income approach and corporate profitability of listed cement firms in Nigeria. In more specific terms the study intends to:

1. Ascertain the effect of income approach on return on capital employed of listed cement firms in Nigeria.
2. Examine the effect of income approach on return on equity of listed cement firms in Nigeria.

Research Questions

The following research questions guided the study:

1. What is the effect of income approach on return on capital employed of listed cement firms in Nigeria?
2. What is the effect of income approach on return on equity of listed cement firms in Nigeria?

Hypotheses

The following hypotheses were tested at 0.05 level of significance.

H_{o1}: Income approach does not have significant effect on return on capital employed of listed cement firms in Nigeria.

H_{o2}: Income approach does not have significant effect on return on equity of listed cement firms in Nigeria.

Literature Review
Fair Value Measurement

Fair value measurement, as defined by International Financial Reporting Standard (IFRS) 13, is the process of estimating the price at which an orderly transaction to sell an asset or transfer a liability would take place between market participants at the measurement date under current market conditions (IASB, 2011). This definition establishes fair value as a market-based measurement, not an entity-specific one. The core purpose of fair value in financial reporting is to enhance the relevance and decision-usefulness of financial statements by providing timely information that reflects the current economic conditions and the true financial position of an entity, moving beyond the static nature of historical cost accounting.

A fundamental principle of IFRS 13 is the exit price concept. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market. This exit price reflects market participants' expectations about future cash flows and the risks associated

with the asset or liability at the measurement date, irrespective of the entity's intention to hold or settle the item.

The accuracy and reliability of a fair value measurement depend on the nature of the inputs used in valuation techniques. IFRS 13 classifies these inputs into a fair value hierarchy that prioritizes their objectivity:

Observable Inputs: These are market data derived from sources independent of the reporting entity, such as quoted prices in active markets for identical assets or liabilities, or other directly or indirectly observable market data.

Unobservable Inputs: These are inputs for which market data is not available, requiring the entity to use its own assumptions about the assumptions market participants would use.

The hierarchy categorizes these inputs into three levels:

Level 1 Inputs: These are unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date. This provides the most reliable evidence of fair value.

Level 2 Inputs: These are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets in active markets, or valuation models using observable market data like interest rate curves.

Level 3 Inputs: These are unobservable inputs used when relevant observable inputs are not available. This level involves significant entity-specific judgment and estimation, such as internal financial forecasts used in a discounted cash flow model (the income approach).

The standard mandates that entities maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy is critical as it directly links to the reliability and potential for managerial discretion in fair value estimates, with Level 3 measurements being most susceptible to subjectivity and agency-related challenges in financial reporting.

Income Approach

The income approach to fair value measurement represents a valuation technique that emphasizes the present value of the future economic benefits expected from an asset or liability and is therefore grounded in discounted cash flow logic that aligns asset valuation with income generating potential. Under IFRS 13, fair value measurement aims to estimate an exit price based on observable or unobservable inputs, yet the income approach relies mainly on projected cash flows, discount rates, and assumptions about economic conditions which position it within Level 3 of the fair value hierarchy. As a present value technique, it requires the careful estimation of expected future inflows and outflows, the determination of an appropriate discount rate that reflects risk and time value of money, and the application of a valuation model that converts these expectations into a single fair value estimate. This makes the income approach particularly relevant in asset intensive industries such as cement manufacturing where long term assets, capital investments, and depreciation schedules influence earnings capacity and corporate value. Within corporate profitability analysis, the income approach is important because changes in fair value arising from updated cash flow projections or discount rate adjustments can affect income statements, equity positions, and profitability

ratios. Measures such as Return on Capital Employed and Return on Equity are sensitive to valuation outcomes since adjustments in asset values, liabilities, and earnings influence both numerator and denominator components of these ratios. The relationship between valuation methods and profitability therefore becomes significant because fair value changes under the income approach may signal improved earning potential or reveal impairment, thereby shaping profitability assessments. In the cement sector where firms operate under fluctuating exchange rates, energy costs, and market demand, accurate valuation becomes essential because subjectivity in cash flow estimation or discount rate selection can either enhance or distort profitability measures, demonstrating why the income approach plays a central role in understanding financial performance dynamics in listed cement firms.

Corporate Profitability

Profitability, often assessed through indicators such as Return on Capital Employed and Return on Equity, remains a central measure of a firm's financial strength and operational effectiveness and serves as an essential guide for both investors and management (Penman, 2007). In capital intensive sectors such as cement manufacturing, profitability outcomes are shaped by valuation practices, economic conditions, and the management of production costs. Accounting measurement choices play an important role in determining reported profits, and the fair value model, especially the market approach which relies on observable market inputs (IASB, 2011), can create fluctuations in earnings through the recognition of unrealized gains and losses (Kieso et al., 2021). The movement from historical cost to fair value is intended to improve relevance by reflecting current economic realities and offering clearer insight for investment decisions (Abiahu et al., 2020). Yet this link between valuation method and profitability adds complexity because market based estimates depend on observable data and managerial judgement, which may influence the consistency and credibility of profitability indicators (Christensen and Nikolaev, 2009; Thesing and Velte, 2021).

Return on Capital Employed captures the pre-tax profit generated from the capital invested in the business and illustrates how effectively a firm uses its capital resources. It is especially important in asset heavy industries where substantial investments in property, plant and equipment are required, and valuation adjustments can modify the capital employed figure, thereby affecting both ROCE and profit reporting (Penman, 2007; Diewert, 2005).

Return on Equity reflects the post-tax profit attributable to shareholders and is a central measure of performance and value creation. Choices relating to asset valuation, including the application of the market approach under fair value accounting, influence equity through revaluation reserves and other comprehensive income which in turn shape ROE outcomes (Kieso et al., 2021). For firms listed on the Nigerian Exchange, ROE carries particular significance as it affects investor sentiment, share pricing, and confidence in management's ability to generate value from shareholder funds (Barlev and Haddad, 2003; Damant, 2001).

Nigerian Cement Industry

The Nigerian cement industry is characterized by its high capital intensity and significant contribution to the nation's construction and infrastructure development.

Firms in this sector, such as Dangote Cement Plc, BUA Cement Plc, and Lafarge Africa Plc, operate with substantial investments in property, plant, and equipment (PPE), including quarries, kilns, mills, and transportation logistics (Adegboye, 2018). These tangible, long-lived assets form the backbone of production capacity and represent a major portion of the firms' balance sheets. The nature of these assets such as durable, specialized, and costly to replace, makes their valuation a critical component of financial reporting and performance assessment.

Due to this high capital intensity, the financial performance and stability of cement firms are deeply sensitive to both internal operational efficiency and external market conditions. The industry faces significant exposure to volatile factors such as foreign exchange rate fluctuations, rising energy and power costs, and persistent inflation (Adegboye, 2018). These economic pressures directly affect production costs, input prices for raw materials, and ultimately, profitability. In such an environment, the valuation of assets cannot remain static. Accurate and current valuation becomes crucial not only for reflecting true economic worth but also for strategic decision-making regarding capacity expansion, maintenance, and financing.

This context underscores the heightened relevance of fair value measurement, particularly the income approach, within the sector. Traditional historical cost accounting may understate or misrepresent the current value of these critical assets, especially during periods of rapid inflation or currency devaluation. Fair value accounting, by estimating the current market value or the present value of future cash flows expected from these assets, provides a more realistic depiction of a firm's financial health and resource utilization (Laux & Leuz, 2009). For stakeholders including investors, regulators, and management, adopting fair value practices in this asset-heavy industry enhances the transparency and reliability of profitability metrics like Return on Capital Employed (ROCE) and Return on Equity (ROE). It ensures that reported profits and asset values are more closely aligned with the contemporary economic challenges and opportunities faced by listed cement firms in Nigeria.

Agency Theory

This study is theoretically anchored in Agency Theory, which elucidates the inherent conflicts of interest and information asymmetries between managers (agents) and shareholders (principals) (Jensen & Meckling, 1976). In the context of financial reporting, managers, as agents entrusted with the stewardship of corporate resources, possess superior information regarding the firm's operations and asset values. This informational advantage can create a divergence between their objectives and those of the principals (investors), particularly when managerial performance and compensation are linked to reported financial outcomes such as profitability. The theory posits that in the absence of perfect monitoring or aligned incentives, agents may engage in opportunistic behaviour, including the strategic use of accounting discretion to influence reported earnings and financial position (Watts & Zimmerman, 1986). The application of fair value measurement, specifically the income approach, introduces a significant dimension to this agency dynamic. As defined by IFRS 13, the income approach values an asset based on the present value of future cash flows expected to be derived from it. This valuation technique is heavily reliant on unobservable inputs (Level 3 of the fair value hierarchy), which require substantial managerial judgment and estimation regarding future economic

benefits, growth rates, and appropriate discount rates (IASB, 2011). This reliance on managerial assumptions creates a fertile ground for information asymmetry, as managers can exercise discretion in these estimates to manage earnings, smooth income, or present a more favorable view of the firm's profitability and stability to the market (Ramanna, 2008; Thesing & Velte, 2021).

Within the Nigerian cement industry, characterized by high capital intensity and significant investments in long-lived tangible assets, the valuation of property, plant, and equipment (PPE) is material to the balance sheet. The choice between historical cost and a forward-looking measure like the income approach can substantially alter the book value of assets and, consequently, key profitability ratios. Agency Theory predicts that managers may utilize the discretion inherent in the income approach to influence metrics such as Return on Capital Employed (ROCE) and Return on Equity (ROE). For instance, by adjusting future cash flow projections or discount rates, managers can affect periodic revaluation gains or losses, thereby directly impacting reported profit and equity. Therefore, this framework provides a robust lens to examine not merely the statistical relationship between the income approach and profitability, but to interrogate the underlying principal-agent incentives and governance mechanisms that shape the application and financial outcome of this valuation technique in an emerging market context like Nigeria.

Methodology

This study adopted an ex post facto research design. The population consisted of three cement manufacturing firms listed on the Nigerian Stock Exchange: Dangote Cement Plc (DANGCEM), BUA Cement Plc, and Lafarge Africa Plc (WAPCO). These firms were selected because they were among the first to adopt International Financial Reporting Standards (IFRS) and comply with Roadmap Committee recommendations for IFRS-compliant financial statements. Secondary data were collected from the firms' published annual reports covering 2009–2014, allowing comparison of reported profits before and after fair value measurement adoption. Data were sourced from the NSE website, capturing five-year periods for each company. The dependent variable was profitability (reported profit), while independent variables were fair value measurement methods Market Approach, Income Approach, and Cost Approach, considered alongside Fair Value Hierarchy levels (Level 1, 2, and 3 inputs). Data analysis employed t-tests to examine differences among the independent variables, comparing reported profits under fair value and historical cost methods. Regression analysis was further applied to assess the relationship between fair value approaches and profitability. This approach ensured a systematic, quantitative evaluation of the impact of fair value measurement on reported profits in Nigerian cement manufacturing firms.

Results and Discussion
Testing of Hypotheses
Ho₁: Income approach does not have significant effect on return on capital employed of listed cement firms in Nigeria

Table 1: Model Summary of Income approach and return on capital employed
Part A: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.946[a]	.896	.861	.07177

a. Predictors: (Constant), Income approach

Table 1 presents the model summary between income approach and return on capital employed of listed cement firms in Nigeria. This table provides the R value and R^2 values; the R value indicates a very strong degree of correlation (.946) and the R^2 value of .896 indicates a variation of 89%. This shows that the model is effective enough to determine the impact. In this case, the value of .896 is good. The Adjusted R-square shows the generalization of the results. In this case, the value is .861, which is not far off from .896, so the model is a good fit.

Part B: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.133	1	.133	25.729	.015[b]
	Residual	.015	3	.005		
	Total	.148	4			

a. Dependent Variable: Return on capital employed
b. Predictors: (Constant), Income approach

The table above shows the analysis of variance. From the above table, the F-statistics is 25.729 and the significance level is 0.015. The decision criterion statement states that, if the P value is less than 0.05 the null hypothesis is rejected if otherwise the null hypothesis is accepted. Hence the P value (Sig) of .015 is less than 0.05 therefore the null hypothesis is rejected. This implies that there is significant effect between income approach and return on capital employed.

Part C: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.800	.852		-.939	.417
	Income approach	1.227	.242	.946	5.072	.015

a. Dependent Variable: Return on capital employed

The coefficient model reveals the t-calculated value of income approach as 5.072 and a Sig. value of .015. This implies that there is significant impact between income approach s and return on capital employed because of the Sig. value which is 0.015, less than the acceptable value of 0.05. Therefore, the analysis suggests that income approach s have a significant effect on return on capital employed of listed cement firms in Nigeria.

Ho₂: Income approach does not have significant effect on return on equity of listed cement firms in Nigeria.

Table 2: Model Summary of Market approach and return on equity
Part A: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.977[a]	.954	.939	.04749

a. Predictors: (Constant), Income approach

Table 2 presents the model summary between income approach and return on equity of listed cement firms in Nigeria. This table provides the R value and R^2 values;

the R value indicates a very strong degree of impact (.97) and the R^2 value of .95 indicates a variation of 95%. This shows that the model is effective enough to determine the relationship. In this case, the value of .954 is good. The Adjusted R-square shows the generalization of the results. In this case, the value is .939, which is not far off from .954, so the model is a good fit.

Part B: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	.141	1	.141	62.635	.004[b]
1	Residual	.007	3	.002		
	Total	.148	4			

a. Dependent Variable: Return on equity
b. Predictors: (Constant), Income approach

The table above shows the analysis of variance. From the above table, the F-statistics is 62.635 and the significance level is .004. The decision criterion statement states that, if the P value is less than 0.05 the null hypothesis is rejected if otherwise the null hypothesis is accepted. Hence the P value (Sig) of .004 is less than 0.05 therefore the null hypothesis is rejected. This implies that there is significant relationship between income approach and return on equity.

Part C: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	-1.553	.641		-2.421	.094
1	Income approach	1.441	.182	.977	7.914	.004

a. Dependent Variable: Return on equity

The coefficient model reveals the t-calculated value of income approach as 7.914 and a Sig. value of .004. This implies that there is significant effect between income approach s and return on equity because of the Sig. value which is .004 less than the acceptable value of 0.05. Therefore, the analysis suggests that income approach s have a significant impact on return on equity of listed cement firms in Nigeria.

Discussion of Findings

The income approach also showed a significant impact on both ROCE and ROE. With a strong correlation (R = .946), it was evident that the income approach is instrumental in improving profitability by accurately estimating the future benefits of assets. This is supported by findings from empirical studies like that of Zhou (2022), which demonstrated that fair value measurements, particularly using the income approach, significantly improve the accuracy of financial statements by reflecting assets' income-generating potential.

Adeyemi's (2021) study in Nigeria further reinforces this, showing that the income approach significantly improves financial performance, especially in sectors where long-term asset utility is crucial, such as cement manufacturing. In this

context, the income approach's ability to provide realistic future cash flow projections adds considerable value to financial assessments, leading to better corporate profitability.

Conclusion

The study examined the effect of the income approach to fair value measurement on the corporate profitability of listed cement firms in Nigeria, with a specific focus on Return on Capital Employed (ROCE) and Return on Equity (ROE). The findings reveal a significant and strong positive relationship between the application of the income approach and both profitability metrics. The statistical analysis confirms that the income approach has a substantial effect on ROCE, leading to the rejection of the null hypotheses. This indicates that the forward-looking, cash-flow-based valuation inherent in the income approach meaningfully influences the reported financial performance of cement firms. The results align with the theoretical expectations posited by Agency Theory, which highlights the role of managerial discretion in fair value estimation. In the capital-intensive Nigerian cement sector, where asset valuation is critical, the income approach provides a mechanism through which the economic reality of assets, reflecting their future income-generating potential is integrated into the financial statements. This enhances the relevance of reported profitability by aligning asset book values with contemporary economic conditions and expectations, thereby offering stakeholders a more accurate assessment of operational efficiency and value creation. In essence, the adoption of the income approach under IFRS 13 contributes to more transparent and decision-useful financial reporting in Nigeria's cement industry. It moves valuation beyond static historical costs, allowing profitability indicators to better reflect the firms' economic substance and long-term sustainability.

Recommendations

Based on the findings of the study the following recommendations were made:

1. Cement firms should establish and disclose a clear, auditable framework for determining the critical unobservable inputs (specifically long-term cash flow projections and discount rates) used in the income approach to fair value measurement, thereby enhancing the reliability and comparability of reported profitability.
2. Regulatory authorities, including the Financial Reporting Council of Nigeria (FRCN), should mandate enhanced disclosures in annual reports detailing the sensitivity of key profitability metrics (ROCE and ROE) to changes in the core assumptions underlying income approach valuations.

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