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# Relevance of Accounting Theory to Business Corporate Governance Performance in Nigeria

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**Abstract**
The study examined the relevance of accounting theory to business corporate governance performance in Nigeria. Company performance Panel data were used and the preliminary tests indicated the use of fixed effect model being appropriate for data analysis. Findings revealed that block ownership leads to increase in company performance while other variables are indifferent to company performance. This has implication to theory and practitioner as accounting profession has made valuable contributions toward ensuring good corporate governance in banking sector. It is recommended that future corporate governance codes should contain provision on board effectiveness and that the organization should be consistent with type of accounting theory adopted in preparation of the various accounting records since there is proportional relationship between accounting theory and corporate performance.
**Keywords:** Accounting Theory, Corporate Business, Corporate Governance, Normative Accounting Theory, Positive Accounting Theory, Large shareholders and Company Performance.

## 1.0 Introduction

Accounting theory is a material field in Accounting. Historically, accounting predates monetary economy. This was precisely, in the era of barter economy (i.e. exchange of goods for goods) when transactions were not only pre-determined by measurement but also by exchange values. The precept in which goods were exchanged at arms-length through concerted efforts of gathering, determining and measuring values are both pre and post ante accounting. The Trade by barter period was characterized by measurement inequality, cumbersome in terms of production variety and coupled with the problem of coincidence of wants, were all-inherent in barter economy. However, the development of accounting theory was to ameliorate the inherent problems encountered in barter economy, unlike monetary economy. It is pertinent to understand the meaning, scope and application of a theory in humanities and management sciences in order to appreciate the work of accounting theory.

Accounting theory", which could be interpreted to mean either speculative interpretations or empirical explanations depending on the preparation of the researcher (Glautier & Underdown, 1997). Many authors argue that there is no generally accepted "accounting theory" currently even though many attempts have been made to formulate one (Riahi-Belkaoui, 2004). According to Hendriksen (1982), "Accounting theory may be defined as logical reasoning in the form of a set of broad principles that (1) provide a general frame of reference by which accounting practice can be evaluated, and (2) guide the development of new practices and procedures, the reality is that accounting theories provides a general frame of reference by which accounting professionals can be judge and also guide the way to development of new principles and procedure (Wood & Sangster, 2002). Accounting theory may also be used to explain existing practices or to obtain a better understanding of them. But the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference to the evaluation and development of sound accounting practice". Theories sometimes give rise to misunderstanding, and may mean different things to different people. This arises because explanations are made at different levels. At one extreme, explanations are purely speculative, resulting in speculative theories. To the natural scientist, speculative theories are not generally theories at all and explanations have to be conclusive before they are given the status of theories. To this end, their assumptions require verification by the test of experience. Empirical theories are constructed by the process of verifying assumptions, or hypotheses, through the test of experience. This process is known as the "scientific method" (Glautier et al 1997).

Over the years, accounting theories have helped to strengthen various assumptions and principles in the financial reporting policies of most organizations. However, despite this advantage, some researchers and globally recognized standard setting bodies, still see some of these accounting theories as contradictory. According to IASB, (2008), the presence of so many alternative in theories, has resulted in several criticism, and this has made it difficult to compare various organizations financial report. Also according to European Commission, (2011) most of the preparers of these financial reports do not give adequate consideration to the different peculiarities in some organizations operations before publishing most of these accounting theories, and this has made it difficult for these organization to adopt these theories.

According to Osho and Ogodor (2018), the concept of corporate governance has become a vital topic for discussion in business circles, more so in an environment like Nigeria where unethical conduct thrives. Osho and

Afolabi, (2018) opined that Corporate governance is regarded as an indispensable tool for organizations to take the lead in the industry of operations. It is about the effective, transparent and accountable governance of affairs of an organization by its management and board.

Based on the above assertion, this study is to examine the relevance of accounting theory to business corporate governance performance in Nigeria.

## 2.0 Literature Review

### 2.1.1 Concept of Accounting Theory

A theory according to American Institute of Certified Public Accountants (AICPA), (1970) is a structure that unifies the underlying logic or system of reasoning. Such theoretical structure, though abstracts from the complexities of the real world is designed to achieve a level of simplicity necessary for analysis.

However, theory is useful in explaining, evaluating and predicting the phenomena associated with a given field of thought like in the case of accountancy. According to Adeleke, Adeyanju and Akinselure (2018), theory is used as basis of explanation with regard to how/why certain phenomena happens the way they do. Explanation as well as prediction offers by theory are important as it enhances our understanding of the phenomena that exist in reality. Osuala (2005), like Okoye (2003) views theory as an attempt at synthesizing, interacting and integrating empirical data for maximum clarification and unification. He added that every individual has a number of personal theories based on postulates and assumptions of varying degrees of adequacy and truth from which he makes deductions of various degrees of crucially and of course of accuracy. Accounting theory is defined as a cohesive set of conceptual, hypothetical and pragmatic proposition explaining and guiding the accountant's actions in identifying, measuring and communicating economic information to users of financial statement, (American Accounting Association (A.A.A). 1966). Wolk, Dodd and Rozycki (2008) opined that accounting theory consist of the basic assumptions, definitions, principles.

Theory is used as basis of explanation with regard to how/why certain phenomena happens the way they do. Explanation as well as prediction offers by theory are important as it enhances our understanding of the phenomena that exist in reality. Riahi-Belkaoui (2014), views accounting theory as ‘a set of scientific hypotheses is a scientific theory if and only if it refers to a given factual subject matter and every member of the set is either an initial assumption or a logical consequence of one or more initial assumptions’. In the same token Unegbu (2014), opines that some accounting theories are either rejected or accepted or continually being revised or modified in other to keep the pace with the increasing complexity of business operations and risks. Knowledge of accounting theory equips a person to exercise independent judgement with confidence besides enabling him to react according to the circumstances (Osho & Moronkeji, 2018). Generally theory is sometimes said to deal with the creation of scheme of ideas which provide definition of the problem observed and the understanding of it

Historically, some accounting theories did not show clear method of calculating profit. In fact, depreciation was virtually absent including method of drawing up a balance sheet, now statement of financial position (Edey, 1970). Perera and Mathews (1996), had a strong view that the initial development of double entry book keeping theory in the Italian city states experienced long period of stagnation, probably because of its non-acceptance in Europe; England, Germany, France and in Italy the home country itself.

Commercial activities at these periods were inactive, though due to size and type of business, which also encouraged the use of single and double entry bookkeeping, without regular closing of entries and income determination (Baxter, 1981). The side effects of these changes on accounting were profound in the development of recording, measuring and disclosure requirements in factories, railways and aggregation of labour and capital equipment. New system of production, ownership and control of assets including methods of providing for depreciable assets were based on accounting assumptions, (Ola, 1985).

Furthermore, prior to company taxation, the early theories of depreciation including replacement cost accounting contend that there was no need for depreciation if the assets were maintained in good condition. This theory however, would produce as many problems as it was meant to solve (Paul, 1985).

Stoner, Freeman. and Gilbert, (2002), did observe also that the emergence of labour in factories led to the need for the development of systems on how to pay wages, overtime, bonuses, piecework and as well as managing the large number of employees that were necessary for the new industries. Accounting systems for wage and production must be designed for that purpose.

The economic and legal changes resulting from industrial revolution, particularly to the aggregation of capital, labour and company legislation brought pressure on the accounting systems that would put the various parties at par. Accounting system that could address aggregation of capital, methods of labour remunerations, depreciable assets, production cost, and income determination was developed, (Dopuch & Sunder, 1980).

### 2.1.2 Large shareholders and business corporate governance performance

The relationship between large shareholders and company performance has remained a resonating topic in the corporate governance and finance literature. Agency theory has been used by pervious researchers to study large share ownership as a corporate governance mechanism that substitutes board monitoring in a weak corporate governance environment. Previous literature examined the monitoring role of large shareholders in listed companies. One strand of literature examined its relationship with executive compensation but does not provide evidence of its influence on company performance (Cheng & Firth, 2005; Firth, Fung, & Rui, 2007; Khan, Dharwadkar, & Brandes, 2005). Another strand of literature examined its relationship with company performance (Boubakri, Cosset and Guedhami, 2005; Chhaochharia et al., 2012; Cronqvist & Fahlenbrach, 2009). Chang (2003) argue that positive relationship between large share ownership and company performance can only hold in countries with efficient capital markets and good corporate governance system.

The various measures used for company performance produced inconsistent results. Using Tobin's Q as a measure of company performance, Cronqvist and Fahlenbrach (2009) report a positive relationship between large share ownership and company performance. With the use of three different measures of company performance, Boubakri et al. (2005) show a significant positive relationship between large share ownership and company performance after privatization in their multi country study spanning the period 1980 to 2001. The findings of Ozkan (2007) support the conjecture that institutional shareholders do adequate monitoring of management as they report institutional shareholders monitoring of CEO cash compensation in UK. Chhaochharia, Kumar and Niessen-Ruenzi, (2012) find companies with high domestic share ownership to be associated with better financial performance as they engage in effective monitoring of management activities.

In contrast to be above findings, Lemmon and Lins (2003) used 800 companies from 8 countries in East Asia to examine the influence of ownership structure on company performance during financial crisis. They find evidence that large shareholders have incentives to expropriate minority shareholders. In another study, Chang (2003) documents that ownership structure does not have influence on company performance of group-affiliated companies in Korea.

Krivogorsky (2006) in her study does not find evidence to support the assertion that the change in percentage shareholdings by institutional large shareholders affects the relationship between institutional ownership and company performance in a no monotonic way.

The governance of a successful corporation typically includes an effective board of directors that carries out its responsibilities with integrity and competence. An effective board must put in place systems to ensure that the organization obligations to its shareholders are met (Osho & Adesanya, 2018). The idea behind the concept of corporate governance is that of governing over institutions, determining how they communicate with their stakeholders and communities in orders to improve their life quality (Ato, 2002 as cited by Muhammed, 2011). Therefore, corporate governance ensures fairness; openness and accountability in all the financial records of an organization. Claessens (2003) opined that good corporate governance arrangement gives great advantage to corporations in the form of more favourable dealings with all stakeholders, better performance, lesser cost of capital and larger access to financing.

#### 2.1.3 Normative and Positive Accounting Research

The major approaches used to perform financial accounting research are the normative and the positive approach. The positive approach is also called the empirical approach, because it is concerned with empirical research. The normative approach is based on the classical theory, which is characterized by the thought that there is only one truth. Furthermore the classical theory claims that the true economic reality cannot be expressed and the users of accounting information accept this information at face value (Ryan, 2002). The normative approach prescribes how things should be done so it can be characterized as a prescriptive approach. The positive approach obtains information from empirical research and is based on facts and neutrality. The positive approach could also be used to test the hypotheses which are a basis for the normative approach empirically. In contrast with the normative approach, which is a prescriptive approach, the positive approach is concerned with prediction and explanation (Ryan, 2002). Positive accounting theory is important, because it can predict and explain the consequences for parties (e.g. financial analysts and investors) who make decisions on accounting information, (Watts & Zimmerman 1986).

### 2.2 Theoretical Review

In this study two theories are of interests which are market based accounting theory and Efficient Market Hypothesis theory.

#### 2.2.1 Market Based accounting theory

The market based accounting approach emerged from several studies which investigated the predictive ability of accounting information. Under this approach the market reaction to reported accounting statements is tested (Ryan 2002), so this can be considered as research, studying the information content of these accounting statements. The market based accounting research approach is a statistical approach and is used in many studies (e.g. Basu, 1997; Balachandran & Mohanram, 2011) to measure accounting conservatism.

Important in market based accounting research are the Efficient Market Hypothesis (EMH) and the Capital Asset Pricing Model (CAPM). The CAPM is used to make a prediction for the expected return on securities. The EMH and the CAPM also have an important role in the development of positive accounting research. Because of the important role of the EMH in accounting research the hypothesis will be discussed more comprehensively.

**2.2.2 Efficient Market Hypothesis theory**

Before the existence of the EMH the assumption was that accounting reports were the only source of company information (Watts & Zimmerman 1986). Because managers were flexible in choosing the accounting procedures, researchers assumed that managers could report the earnings they want and as a consequence could mislead the stock market. Based on this assumption and the absence of a single concept for measuring earnings, researchers argued that earnings numbers were useless (Watts & Zimmerman 1986). As a result, researchers claimed that accounting procedures should be the same for all companies to make earnings useful.

The EMH led to another view of accounting reports. The EMH criticize the assumptions discussed above and conclude that accounting earnings could be useful if they are associated with stock prices.

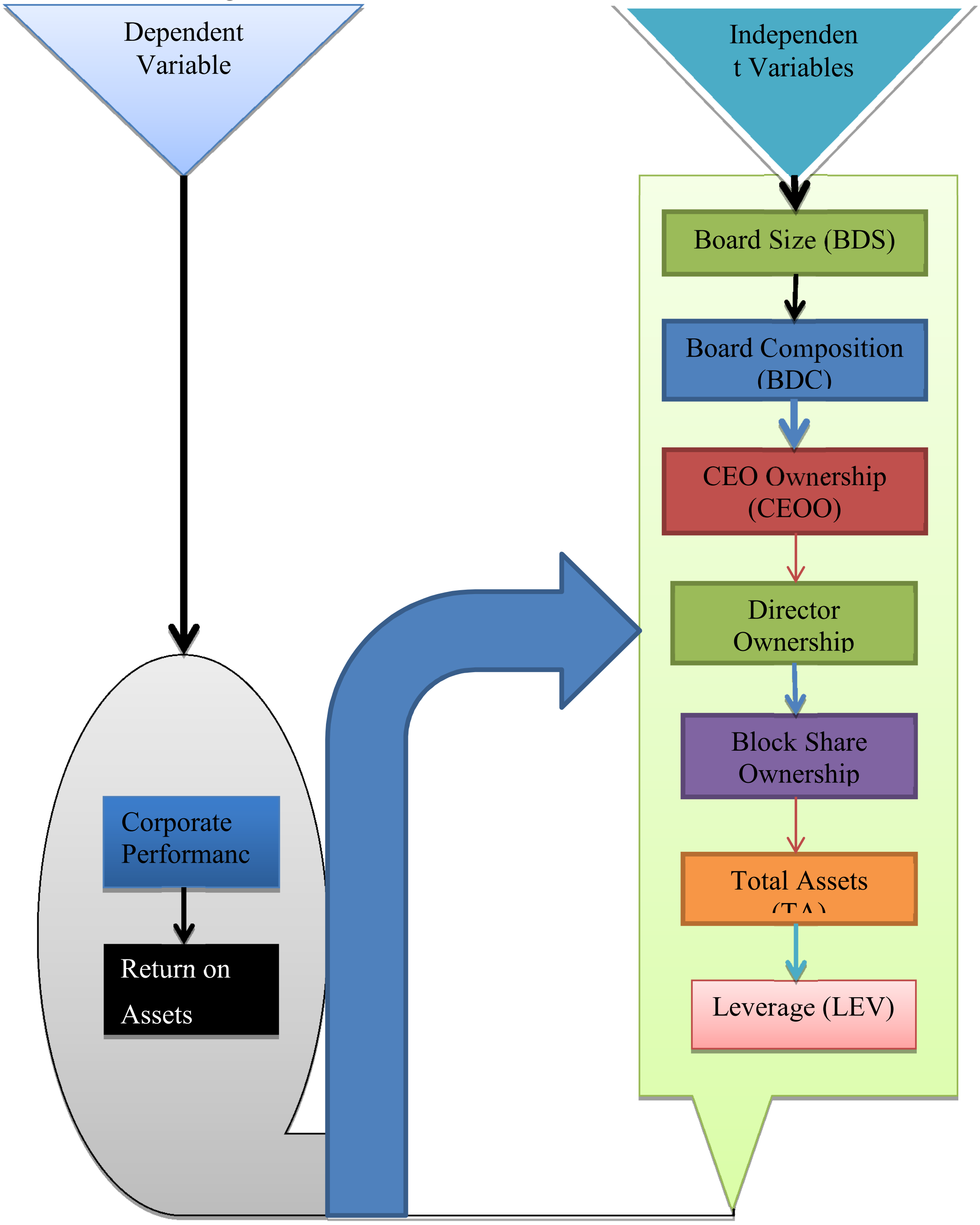
Ball and Brown (1968) investigated if accounting earnings and stock prices were associated and found empirical evidence for an association between these variables. The association between earnings and stock prices could imply that earnings reflect factors which are already incorporated in stock prices, but could also imply that the announcement of earnings convey information to the stock market. If the earnings announcement conveys information to the stock market the earnings have information content. Ball and Brown (1968) found evidence for both of these effects of earnings on stock prices.

The EMH states that all publicly available information is reflected in stock prices and that capital markets react in an efficient and unbiased manner to this information. The market is efficient if stock prices reflect immediately and fully all available information.. The EMH gives three possibilities, the weak, the semi-strong and the strong form. Under the weak form stock prices only contain historical info on share prices. Under the semi-strong form stock prices contain all publicly available information and under the strong form stock prices reflect all available (publicly and insider) information at that time. According to Watts and Zimmerman (1986) and many other researchers, the existing evidence is consistent with the semi-strong form making this form the most likely one. As a result, in this thesis it will be assumed that the market is efficient in the semi-strong form.

The EMH is important for research to accounting conservatism. Given the similarities that exist between accounting earnings and stock prices and the EMH researchers began to investigate predictions and explanations of accounting choices. For example, Watts (2003a, 2003b) explains why managers choose for conservative accounting procedures instead of non-conservative accounting procedures.

Furthermore, based on the evidence for an association between accounting numbers and stock prices, several studies measure the level of conservatism by analyzing the association between these variables. For example, Beaver and Ryan (2000) use the book-to-market ratio to measure the level of conservatism and Basu (1997) measures conservatism by investigating if accounting earnings incorporate positive stock returns faster than negative stock returns. Basu (1997) uses negative stock returns as a proxy for bad news and positive returns as a proxy for good news, based on the EMH that stock prices immediately and fully reflect all available information.

**2.3 Conceptual Framework of Relevance of Accounting Theory to Business Corporate Governance Performance in Nigeria**




**Source:** Researchers' Relevance of Accounting Theory to Business Corporate Governance Performance in Nigeria Model

**3.0 Methodology**

The relationship between accounting theory to business corporate governance performance in Nigeria was examined using Panel data met analysis because Panel data permits for the control of unobservable company characteristics and also helps ease the problem of correlated omitted variables (Conyon & He, 2011; Graham, Li, & Qiu, 2012; Wooldridge, 2002). When there are correlated omitted effects, panel data helps to get consistent estimates of the parameters of interest which is not ordinarily possible with OLS on individuals' cross sections (Johnston & DiNardo, 1997). Based on this study, the appropriateness of the fixed-effects model by conducting firm-fixed effects test, time-effects test, random effects test, and Hausman's specification test is adopted. The regressions were run after conducting heterosedasticity and serial correlation tests. The sample size consists of six banks listed on the Nigerian Stock Exchange (NSE) covering the period 2013 – 2017 with a balance panel data set using the STATA software preliminary tests which indicate the use of fixed effect model as appropriate for data analysis.

**3.1 Model specification**

ROA $(Perf)_{it} = \alpha it+\beta_1 BDS_{it}+\beta_2 BDC_{it}+ \beta_3 CEOO_{it}+\beta_4 DIROit+\beta_5 BLKOit+\beta_6 TAit+\beta_7 LEVit+£it$

Where:

ROA = Return on Assets
BDS = Board size
BDC = Board composition
CEOO = CEO Ownership
DIRO = Director Ownership
BLKO = Block share Ownership
TA = Total Assets
LEV = Leverage

**4.0 Empirical Results**

Table 1: Descriptive Statistics and Variance Inflation Factor
Variables: Mean Std. Dev. Minimum Maximum VIF (N = 30)

| **Variables** | **Obs.** | **Mean** | **Std. Dev** | **Min** | **Max** |
|---|---|---|---|---|---|
| **Variable** | **Obs.** | **Mean** | **Std. Dev** | **Mo** | **M** |
| Companies | 0 | | | | |
| Code | 30 | 40.5 | 1.737021 | 38 | 43 |
| Year | 30 | 2015 | 1.43839 | 2013 | 2017 |
| BOS | 30 | 13.66667 | 3.417332 | 6 | 20 |
| BDC | 30 | .182806 | .1052205 | 5 | .9090909 |
| ROA | 30 | .0197073 | .0230343 | .0329431 | .0605655 |
| ROE | 30 | .0268184 | .7592978 | -.3.866192 | .833376 |
| GRT | 30 | .1695315 | .2584197 | -5077016 | .7511845 |
| LEV | 30 | 11.7056 | 31.12004 | -4.292821 | 175.5641 |
| DIRO | 30 | .0566201 | .1648015 | 4.47e-07 | .9106368 |
| CEOO | 30 | .0095623 | .0229364 | 0 | ,0950201 |
| EXDIRO | 30 | .0125357 | .0247939 | 2.66e-07 | .0989074 |
| BLKO | 30 | 22.21167 | 18.60614 | 0 | 79.85 |
| MNCO | 30 | 0 | 0 | 0 | 0 |
| TA | 30 | 1.61e+09 | 1.01e+09 | 1.51e+08 | 3.87e+09 |
| P | 30 | 0 | 0 | 0 | 0 |
| LEVE | 30 | .8321296 | 0 | .8321296 | .8321296 |

**Source:** Researchers' Descriptive Statistics and Variance Inflation Factor Computation

The different variables used for this study as presented in Table 1 shows the study descriptive statistics. The result indicates that the mean business corporate governance performance is 1.97 per cent with a minimum of -3.29 per cent and a maximum of 6.06 per cent. The average board size is 13.67 ranging from 6 to 20. The result shows that 61.83 per cent of the sample banks have independent boards with a minimum of 50 per cent and maximum of 90.91 per cent. The mean CEO ownership is 0.09 per cent with a minimum of 0 per cent and a maximum of 9.5 per cent. The directors average share ownership is 5.66 per cent ranging from less than 1 per cent to 91.06 per cent respectively.

**4.2 Correlation and Multi-collinearity Analysis**

Table 2: Correlation Matrix

| | ROA | BDS | BDC | CEOO | DIRO | BLKO | TA |
|---|---|---|---|---|---|---|---|
| **ROA** | 1.0000 | | | | | | |
| **BDS** | -0.0645 | 1.0000 | | | | | |
| | 0.7349 | | | | | | |
| **BDC** | -0.1523 | -0.5270* | 1.0000 | | | | |
| | 0.4218 | 0.0028 | | | | | |
| **CEOO** | 0.0709 | 0.0738 | -0.2562 | 1.0000 | | | |
| | 0.7096 | 0.6984 | 0.1718 | | | | |
| **DIRO** | -0.3115 | 0.1394 | 0.0208 | 0.1536 | 1.0000 | | |
| | 0.0938 | 0.4626 | 0.9130 | 0.4178 | | | |
| **BLKO** | -0.0974 | -0.3298 | 0.1519 | -0.0983 | -0.0034 | 1.0000 | |
| | 0.6088 | 0.0751 | 0.4229 | 0.6055 | 0.9856 | | |
| **TA** | 0.4160* | 0.0039 | 0.0090 | -0.0113 | -0.1914 | -0.7179* | 1.0000 |
| | 0.0222 | 0.9838 | 0.9626 | 0.9525 | 0.3109 | 0.0000 | |
| **LEV** | -0.3075 | -0.0087 | 0.1402 | -0.1005 | -0.0786 | 0.1080 | -0.2371 |
| | 0.0983 | 0.9638 | 0.4598 | 0.5971 | 0.6799 | 0.5702 | 0.2071 |
| | LEV | | | | | | |
| **LEV** | 1.0000 | | | | | | |

***, **, *. Significant level at 1 per cent, 5 per cent, & 10 per cent respectively

**Source:** Researchers' Correlation Matrix Computation

From the above correlation matrix reported in Table 2, the company performance shows significant correlation with board size, board composition, CEO ownership variables; directors' share ownership, and block share ownership. It can be seeing that there is a negative correlation between performance and domestic large shareholders even though at an insignificant level.

Domestic large shareholders and directors' ownership show significant correlation with five other independent and control variables. CEO share ownership has a significant negative relationship with performance. While the result of CEO ownership can be interpreted as expropriation by the CEOs, that of the foreign large shareholders is an indication that they will do proper monitoring of management at ensuring that they deliver value to the shareholders.

Significant correlation between variables could be indication that multi-collinearity is an issue. The highest correlation is between BDS and SIZE but not more than 0.80. Further, the variance inflation factor (VIF) test was conducted for the independent and control variables. All the variables reported a score less than 3 suggesting that multi-collinearity issues are not present in this study.

The business corporate governance performance shows positive correlation with total assets and is negatively correlated with leverage. Board size shows negative correlation with board composition. Total assets are negatively correlated with block ownership. It shows high correlation ($r$ = -0.7179) but is still within the acceptable range.

**5. Conclusion**

The study has examined whether corporate governance performance leads to increase company performance in Nigeria bearing in mind the valuable contributions of accounting profession toward ensuring good corporate governance for the practitioners. Thus, this was done by examining the relationship between board structures, ownership structure and business corporate performance after controlling for company size and leverage. The findings show that block ownership leads to increase in business corporate performance while other variables are indifferent to business corporate performance. The result supports theoretical contentions that large shareholders substitute for effective business corporate governance mechanism in Nigeria with weak investor protection rights; this has implication to theory and practitioners.

According to Osho and Afolabi (2018), to ensure good board practices, the boards should play a role in supervising the risk management and internal audit function of their banks. Corporate governance is all about good business behavior anchored on transparency and accountability while balancing the stakeholders' interests and advancing shareholders wealth (Udeh & Ugwu, 2014). The Nigerian corporate reporting system offers a distinctive environment for evaluating the influence of corporate governance mechanisms on the relevance of accounting theory to a corporate business because the external governance mechanisms are relatively weak compared to other countries of the world such as USA and UK. Therefore, accounting theory may mean purely speculative interpretations or empirical explanations of corporate business performance of events for economic decisions. The governance of a successful corporation typically includes an effective board of directors that carries out its responsibilities with integrity and competence. An effective board must put in place systems to ensure that the organization obligations to its shareholders are met.

Based on the above findings, it is recommended that:

- Future Corporate Governance codes should contain provisions on board effectiveness.
- Director's ownership should be increased in corporate business so as to make them align their interest with those of the shareholders.
- The regulators should mandate the boards to be effective in monitoring managerial actions that will promote the interest of the shareholders.

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