International Journal of Economics, Commerce and Management
United Kingdom Vol. VI, Issue 4, April 2018
http://ijecm.co.uk/ ISSN 2348 0386

IMPACT OF ACCOUNTING THEORY ON FINANCIAL REPORTING IN NIGERIA

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Abstract

The study focuses on the impact of accounting theories on financial reporting in Nigeria quoted companies. It is based on primary data obtained from distribution of four hundred (400) questionnaire to some selected quoted companies. These companies were selected based on purposive sampling. The variables considered in the study were accounting theories and financial reporting which were represented by normative and positive theory and information in the financial statement respectively. The hypotheses of this study were tested at 5% level of significance and statistical analysis used for this study was based on multiple regression analysis. the result of the analysis shows that there is significant relationship between positive accounting theory and information contained in the financial statement, this because the P-value obtained (0.003) was lower than the benchmark value of 5% specified in SPSS for this analysis(i.e.0 ≤ P-value ≤ 0.003). Based on the findings, study recommends that organization should be consistent with type of accounting theory adopted in preparation of their various accounting records since there is proportional relationship between accounting theory and financial reporting.

Keywords: Accounting Theory, Financial Statement, Financial Reporting, Normative accounting theory, Positive accounting Theory

INTRODUCTION

Accounting theory", which could be interpreted to mean either speculative interpretations or empirical explanations depending on the preparation of the researcher(Glautier, and 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 and 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 gives 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)

How organization present information in its financial statements is very important because financial statements are a central feature of financial reporting, and this is, a principal means of communicating financial information to the various stakeholders aside from the investors.

Globalization and transnational business expansion has resulted in an increased need for uniform rules so that the financial statements in different countries are prepared on a similar basis, and there would be no opportunity for interpretation. Although, at an international level different professional accounting organizations have made efforts to harmonize financial reporting rules, there has been a lot of criticism on the address of financial statements for many reasons. Firstly, there are too many alternative ways to report financial information in the financial statements (IASB, 2008). This makes it difficult to compare the financial statements of different entities, and provides opportunities to false conclusions about the success of the activities of the entity. Secondly, the entities in different countries have different demands on how to draft financial statements (European Commission, October 2011).

This situation complicates the interpretation of the entities' financial results and comparisons of financial reports at the international level. Thirdly, the financial reporting requirements set on companies often do not take into account the size of the company and this raises the question of the need for differential reporting (Cole, Branson, & Breesch, 2012; Evans, Gebhardt, Hoogendorn, Marton, di Pietra, Mora, Thinggard, & Vehmanen, 2005; Collis, Dugdale, & Jarvis., 2001). Fourthly, what users review in the financial statements differs, and therefore, when drafting the financial statements, the company should bear in mind the interests of the most significant user groups (Cole, Branson, & Breesch, 2012, Sian and Roberts, 2009).

Statement of the problem

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. The problem of this study is to examine if some specific theories (e.g normative and positive theory) also have controversial meaning to organization.

Research Objectives

The main objective of this study is to determine the impact of accounting theory on financial reporting while the specific objectives are to:

1. determine if positive accounting theory have any effect on information contained in financial statement
2. ascertain if there is any impact between normative accounting theory and information contained in financial statement.

Research Questions

1. To what extent does positive accounting theory have effect on information contained in financial statement?

2. What impact does normative accounting theory have on information contained in the financial statement?.

Research Hypotheses

Ho_1 Positive accounting theory does not have effect on information contained in the financial statement

Ho_2 Normative accounting theory does not have impact on information contained in the financial statement

LITERATURE REVIEW

Conceptual Review

Accounting theory is a material field in Accounting. Historically, accounting predates monetary economy. This was precisely, in the era of barter economy (i.e. where exchange of commodities for goods and vice versa) 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 prevalent 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.

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. 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. It will be useful to state that the word 'theory' is used at different levels even in the history of accounting.

Accounting theory may mean purely speculative interpretations or empirical explanations of events for economic decisions. 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) opine 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. 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. The benefits of Accounting Theory include amongst others:

- To guide the body responsible for establishing accounting standards.
- To provide a frame of reference for resolving accounting questions in the absence of a specific promulgated standard.
- To determine bounds for judgment in preparing financial statements.
- To increase financial statement's users' understanding of and confidence in financial Statements.
- Enhance comparability.
- Improve the image of the profession.

Theoretical Review

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 and Zimmerman 1986).

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 and 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.

Efficient Market Hypothesis theory

Before the existence of the EMH the assumption was that accounting reports were the only source of company information (Watts and 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 and 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.

Empirical Review

Historically, some accounting theories did not show clear method of calculating profit. Infact, 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, Chatfield (1977) like Omolehinwa (2004) observes that where depreciation was not charged, costs were understated, profit overstated and dividends were paid out of capital. 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. Akanni (1998), observes that in every organization, both the employers and employees have sworn to be enemies, though one cannot do without the other because employees need wages and employers need labour for production. 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 and Sunder, 1980).

METHODOLOGY

This study is based on survey research approach, which is based on distribution of questionnaire, The sampling technique used for this study is stratified sampling technique, which involves dividing the quoted companies into sectors and selecting the 25 companies proportionally across the sectors, these sectors include the following services, conglomerates, construction and real estate, financial service, consumer goods, health care, industrial goods, ICT, oil and gas while the sample size was determine using purposive sampling technique, while the sampling size, for the questionnaire respondent was determined by using infinite population formula, this formula was chosen because of the large number of shareholders and other investors involved in the quoted companies selected for this study. The formula is computed as follows;

$$SS = \frac{Z^2 \times (p) \times (1-P)}{C^2}$$

SS = Sample Size

Z = Z-value (e.g., 1.96 for a 95 percent confidence level)

P = Percentage of population picking a choice, expressed as decimal

C = Confidence interval, expressed as decimal ($0.05^2 = 0.0025$)

The Z-values for confidence levels (i.e. ∞ to z)

1.645 = 90 percent confidence level

1.96 = 95 percent confidence level

2.576 = 99 percent confidence level

$$SS = \frac{1.96^2 \times 0.5 \times 0.5}{0.0025}$$

$$= \frac{3.8416 \times 0.5 \times 0.5}{0.0025}$$

= 384.16 Approximately = 400

The four hundred (400) questionnaires were distributed among the various user of accounting information interested in financial reporting and financial performance of quoted companies

Model Specification

This model is based on the description of the relationship between the dependent and independent variables of this research work.

Y = f (X) ---(i)

Where Y = dependent Variable - Financial Reporting represented by information on the financial statement.

X = Independent Variable is Accounting Theories represented by Normative and Positive accounting theories

The multiple linear regression model for this study is defined as:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_{2} + e$ -- (ii)

Regression line equation: $InfonFst = \beta_0 + \beta_1 NmAthry + \beta_2 PstAhry + e$

Where: β_0 = Constant

InfonFst = Information on the financial statement

NmtAhry = Normative accounting theory

PstAhry = Positive accounting theory

β_1 and β_2 : Regression parameters.

e = error term

ANALYSIS AND FINDINGS

Test of Hypotheses

- **Decision Rule**

Accept Alternative hypothesis if the P-Value obtained by ANOVA, coefficient of regression using SPSS is lower than 5% which is the benchmark value specified in SPSS for this analysis, but, if otherwise, reject the Alternative hypothesis and accept the Null Hypothesis.

- **Statistical Analysis for Hypothesis One**

$Ho_{1:}$ Positive accounting theory does not have effect on information contained in the financial statement

Table 1. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.943[a]	.889	.888	.53982

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	346.265	1	346.265	1.188E3	.003[a]
	Residual	43.128	148	.291		
	Total	389.393	149			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.746	.103		-7.221	.000
	Accounting Theory	1.150	.033	.943	34.471	.003

The Regression analysis above shows that the Model summary statistics reveals that Pearson correlation coefficient represented by letter **''r''** is 0.943 which indicate that there is strong positive correlation between positive accounting theory and information contained in the financial statement. Also, the regression analysis result, reveal that the value of the R Squared is 89% (i.e.0.889) and this implies that 89% of the variation in the independent variable can be accounted for by the dependent variable, while the remaining 11% can be accounted for by other factors outside the model. This means that positive accounting theory have great impact on the information contained in the financial statement. Also, the result of the analysis of variance statistic (ANOVA) reveal that positive accounting theory has significant impact on information contained in the financial statement. This is because the P-value obtained (i.e. 0.003) was lower than the significance value of 5% specified in SPSS for this analysis. Hence, according to the decision rule the null hypothesis will be rejected while the Alternate hypothesis will be rejected. This interpretation was also supported by the result of the coefficient of regression, since it, show that that P-value obtained is (0.003), and this also establish that there is statistical significant relationship between positive accounting theory and information contained in the financial statement.

- **Statistical Analysis for Hypothesis two**

Ho_2 Normative accounting theory does not have impact on information in the financial statement

Table 2. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.844[a]	.712	.710	.82392

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	248.706	1	248.706	366.370	.001[a]
	Residual	100.468	19	.679		
	Total	349.173	20			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.071	.157		.451	.653
	Accounting Theory	.963	.050	.844	19.141	.001

The Model summary above indicate that the value of Pearson correlation coefficient represented by letter ''R'' is 0.844 which indicate that there is strong positive correlation between the dependent and independent variable, and this indicates that normative accounting theory have strong statistical impact on information contained in the financial statement. Also, the regression analysis result, reveal that the value of the R Squared is 71.2% (i.e.0.712) and this implies that 71% of the variation in the dependent variable can be accounted for by the independent variable , while the remaining 28.8% (i.e. 28.8%) can be accounted for by other factors outside the model. This, also support the fact, that a change in the normative accounting theory will also lead to significant change in the information contained in the financial statement. Furthermore, the result of the analysis of variance statistic (ANOVA) also lend credence to the fact that an increase in the use of normative accounting theory will lead to significant changes in the information contained in the financial statement. This is because the P-value obtained (i.e.0.001) using SPSS was lower than the significance value of 5% specified in SPSS for this analysis. Hence, according to the decision rule the null hypothesis will be rejected while the Alternate hypothesis will be accepted. This means that normative accounting theory has direct influence on information contained in the financial statement. This was also corroborated by the result of the coefficient of regression, because it shows a P-value of (0.001), which also establishes that there is statistical significant relationship between normative accounting theory and information contained in the financial statement (financial reporting).

Discussion of Findings

The finding of this study confirms that accounting theory has significant relationship with the financial reporting of quoted companies in Nigeria. This is because positive accounting theory has significant impact on information contained in the financial statement, and this was confirmed by the P-value obtained (0.003) from the statistical analysis. The findings of the study also shows that normative accounting theory has significant effect on information contained in the financial statement, because the P-value obtained (0.001) was lower than the benchmark value of 5% specified in this analysis. This findings are similar to the interpretation given by (Ryan, 2002) (Watts and Zimmerman 1986), who emphasized that both normative and positive theories have significant impact on accounting records of organization.

CONCLUSION

This study conclude.that positive accounting theory has significant impact on information contained in the financial statement, and this was confirmed by the P-value obtained (0.003) from the regression analysis. The findings of the study also shows that normative accounting theory has significant impact with information contained in the financial statement, and this because the P-value obtained (0.001) was lower than the benchmark value of 5% specified in this analysis.

RECOMMENDATIONS

-Quoted organization should ensure there are consistency in the accounting theory adopted in preparation of their records, since this study has established statistically that accounting theory has significant relationship with financial reporting

-Also, quoted companies must ensure that accounting theories adopted by them are not contradictory, that is, they must adopted accounting theory that are comparable with companies that are in same line of business with them.

-Companies are also advised to engage professionals in the process of preparation and presentation of their financial statements in line with current practice in Nigeria for adoption of International Financial Reporting Standards (IFRSs).

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