

**CORPORATE GOVERNANCE AND ACCOUNTING  
CONSERVATISM**

**OKEREKE CHINAZOR HOPE**

**MATRIC NO: SBS/2011940020**

**BEING A PROJECT WORK SUBMITTED TO THE  
DEPARTMENT OF ACCOUNTANCY, SCHOOL OF BUSINESS  
STUDIES AUCHI POLYTECHNIC, AUCHI.**

**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR  
THE AWARD OF HIGHER NATIONAL DIPLOMA (HND) IN  
ACCOUNTANCY**

**NOVEMBER, 2022**

## CERTIFICATION

We the undersigned hereby certify that this project titled **“Corporate Governance and Accounting Conservatism”**, was carried out by **Okereke Chinazor Hope** with Matric. No: SBS/2011940020 under our supervision in the Department of Accountancy, Auchi Polytechnic, Auchi, Edo State.

We also certify that the project is adequate both in scope and quality and submitted to the Department of Accountancy in requirements of the award of Higher National Diploma (HND) in Accountancy.

\_\_\_\_\_  
**Dr. Ihimekpen A. F.**  
**Project Supervisor**

\_\_\_\_\_  
**Date**

\_\_\_\_\_  
**Mr. Abumere D.I.**

\_\_\_\_\_  
**Date**

**Head of Department**

**DEDICATION**

This project work is dedicated to God Almighty for His grace and unending mercies in my life throughout my programme in Auchy polytechnic.

## **ACKNOWLEDGMENTS**

I am grateful to God almighty that sustained me this day and gave me good health and guidance to write this project.

My profound gratitude goes to my project supervisor Dr. Ihimekpen A.F for his encouragement, supervisor who spares no efforts in rendering me helpful suggestion when necessary in my project work.

I wish to express my sincere thanks to Auchi Polytechnic Auchi for accepting me into the Higher National Diploma (HND) program in addition am deeply indebted to the various authors I got my research work from.

A big thanks to my beloved parents Mr. and Mrs. Okereke for their love, care, prayer and financial support.

I will not fail to acknowledge my wonderful sibling Ebube, Kosi, Onyedi and to my nephew and nieces Emmanuel, peter and Hannah also my uncle pastor Emeka and Mr. Dele Bagudu, I will not forget all the encouragement may God continue to bless you.

I also wish to acknowledge my friends Ebere, Adaora, Toyosi, Chinonso, Cynthia, Esther, Elsaucer, Ajuma, Christ, Bella and my beloved Airaodion Felix Knowles.

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## **Abstract**

*This study examined corporate governance and accounting conservatism and the objective of the study is to examine the relationship between corporate governance (CG) and conservative accounting of companies in Nigeria. This study employed the ordinary least square regression method to analysis the data gathered to analyse the secondary data collected. It was discovered that there was a high association between accounting conservatism and board independence as well as a positive correlation between outside directors and accounting conservatism when utilizing the aggregate index as a proxy for strong boards. Furthermore, companies with a high proportion of independent directors are less likely to restate or manipulate earnings or publish fraudulent financial statements. It was advised that companies increase the number of nonexecutive members on their boards based on the study's results and conclusions, since this can produce the certainty required for better financial reporting. Additionally, companies should have a limited board size to improve conservative reporting.*

## **CHAPTER ONE**

# INTRODUCTION

## 1.1 Background to the Study

The upsurge of accounting scandals within the last few years that resulted in the sudden collapse of high profile companies such as Enron and WorldCom in the United States of America, HIH, One-Tel and Harris Scarfe in Australia and some companies in Nigeria like AIB Plc and AP Oil have led regulators, investors, academics and the general public to focus on improving corporate governance and accounting quality. Anecdotal evidence suggests that weak corporate governance and earnings manipulation were the main drivers of these collapses. For example, to a large extent Enron's Collapse was caused by the audit committee's lack of independence, which resulted from poor governance (Lavelle, 2017), and the (Horwath, 2018) corporate Governance report stated that a common attribute of recent Australian failed companies is that all had poor corporate governance. Likewise, Dandago, Akintoye, Obisesan, Enigbokan, Adegun, Popoola, Offiah, & Ogunjubom, (2017), also alleges that the collapse of Enron, World Com, Tyco International were caused by poor corporate governance.

The concept of conservatism in accounting practices has remained a predominant characteristic of the accounting field for several centuries. Conservative accounting has been practiced by firms for centuries and it is an important attribute of earnings. It has also been used to measure earnings quality by prior studies (Roslinda, 2019). Initially, conservative accounting was generally viewed as an accounting bias that resulted in low book values. However, recent studies distinguished between accounting bias resulting

from timelier reporting of economic losses relative to gains (conditional conservatism) and accounting bias associated with a predetermined understatement of book values (unconditional conservatism) and argued that these two factors are not equally important from the contracting perspective.

Empirical studies Caskey, & Laux,. (2017); Donglin, & Song, (2009); Futing, (2015) have since focused on establishing a link between corporate governance and accounting conservatism. If firms adopt more conservative accounting procedures, the result will be a reduction in the number of profits being reported in financial statements, and hence, the perception of lesser accounting performance (i.e. a downward bias in tests of any governance – performance relationship). Moreover, if market participants fail to recognize a link between conservative accounting and corporate governance characteristics, then the result is likely to be that firms with better governance are undervalued. Hence, studying whether corporate governance increases the supply of conservatism is potentially interesting and important to regulators, investors and academics. Therefore, the extent of any link between conservative accounting and corporate governance is of considerable interest.

Thus, empirical evidence has shown a direct association between corporate governance mechanism and the implementation of conservative accounting policies Leventis, Dimitropoulos, & Owusu-Ansah, (2013); Artiach, & Clarkson, (2013); Callen, Guan, and Qiu, (2014). In spite of the importance of these two issues and their significant advantages as well as robust international literature, there is a paucity of literature in

Nigeria: these include that of Sanda, Mikailu & Garba, (2019). Looking at the studies, time lag, and different proxy selected as well as techniques for data analyses this study filled the gap in academic research by ascertaining the impact of corporate governance on accounting conservatism.

## **1.2 Statement of the Problem**

Conservatism is a fundamental feature of quality financial statements because it enhances the reliability of financial statements by facilitating effective monitoring of managers and contracts as part of corporate governance mechanisms (Basu, 2019). Given that conservatism entails timely recognition of losses than earnings and avoids over estimation of firms value, it therefore reduces bankruptcy risk in firms.

Advocates of conservatism posit that it benefits the users of financial reports, as it increases firm value by constraining management's opportunistic payments to themselves or other parties which will ultimately be shared among all parties to the firm, increasing their welfare (Beatriz & Penalva 2019). Conservatism is beneficial for creditors, minority stockholders, the firm as a whole and regulatory authorities (Zhang 2020). Recent researches has shown relationship between sound corporate governance mechanisms and accounting practice, with stronger corporate governance structures improving the implementation of conservative accounting policies.

Lack of adequate enforcement with good monitoring results in poor governance and bad governance brings about financial reporting failure (Norwani, 2019). This was

evidenced in the fall of some companies such as Cadbury and Lever Brothers Nigeria Plc. (now Unilever Nigeria Plc.) and this negatively affected stakeholders' confidence on reliability of financial reporting practices of companies. The fall of companies is acclaimed to poor accounting practices which result in unethical conduct and misuse of power (Aggarwal, 2017), poor and weak corporate governance, thus influencing the financial practices in firms. Therefore, absence of integrity, accountability and transparency brings about poor financial practices (Norwani, 2019).

Management often tends to use aggressive accounting especially when their reward is based on their performance which in turn becomes harmful to firms. Some of the activities lead to poor conservative reporting. However, good corporate governance brings about good practices in firm. Firms with good and strong corporate governance have higher conservative reporting (Amran, 2019). Good governance significantly increases conservative reporting. Several empirical evidence exist in the developed world focusing on corporate governance and conservatism with little attention in the developing countries. Some studies focused on a particular industry, financial or non-financial industries. The study therefore, investigates corporate governance and conservatism of quoted firms in Nigeria, addressing; what is the relationship between board independence, board size audit committee independence and conservatism. Hence, this study explored effect of corporate governance on conservatism of quoted manufacturing firms on the Nigerian Stock Exchange (NSE) 2022 so as to validate the mixed results of findings from other studies.

### **1.3 Research Questions**

The following research questions will guide this research study;

- i. What is the relationship between board independence and conservative accounting?

### **1.4 Objectives of the Study**

The main objective of the study is to examine corporate governance and accounting conservatism, the specific objectives are:

- i. To examine the relationship between board independence and conservative accounting.

### **1.5 Statement of Hypotheses**

The following null hypotheses will be tested in this study;

#### **Hypothesis One**

**H<sub>1</sub>:** There is no significant relationship between board independence and conservative accounting.

### **1.6 Scope of the Study**

The research study examines corporate governance and accounting conservatism. The focus of this study is on selected manufacturing firms in Nigeria stock exchange, with particular reference to selected firms in Edo state from 2015 to 2021. This research work

will cover corporate governance, proxied by board independence, board size audit committee independence.

### **1.7 Significance of the Study**

This research will help to improve how accounting conservatism is used to indicate the empirical results or to identify some issues and to debate in emerging market.

Furthermore, this research will play an important role in the accounting area and accounting research development market, as well as will add to the overall literature about accounting conservatism.

In line with prior research, this research work will show the effects of corporate governance on accounting conservatism, to support and enhance the academic study.

Other researchers, who will also want to work on the same or similar topic, might need a base from which to start their work.

### **1.8 Limitation of the Study**

The study certainly suffers from a number of limitations prominent among which include;

- i. Unavailability of adequate materials needed to carry out an effective and reasonable research.
- ii. The inability to obtain all required information.
- iii. The depth to which information could have be gathered is limited for instance, it is inherit in human nature that some times what is being said is quite different from what is being done
- iv. Sizable quality of information obtain from papers were in fragmentations and

sometimes complex.

### **1.9 Definition of Terms**

**Corporate Governance:** is defined, described or delineated in diverse ways, depending on the writer's purpose. Writers focused on a disciplinary interest or context (such as accounting, finance, law, or management) often adopt narrow definitions that appear purpose-specific. "Corporate governance" describes the processes, structures, and mechanisms that influence the control and direction of corporations.

**Accounting Conservatism:** Accounting conservatism is a set of bookkeeping guidelines that call for a high degree of verification before a company can make a legal claim to any profit. The general concept is to factor in the worst-case scenario of a firm's financial future.

#### **Investment Decisions:**

This relates to allocation of capital and involves decisions to commit funds to long term assets, which will yield benefits in future.

#### **Security:**

Security is a financial asset which earns a fixed and or variable periodic income till terminal maturity period if any.

#### **Stakeholder:**

This can be seen as a person or one who has interest (stake) in a system or is affected by or who can influence but not directly involved with the system.

**Investment:** This is the act of committing money or capital to an endeavor with the expectation of obtaining an additional income or profit.

**Budgeting:** Budgeting is the process of planning future business activities by establishing performance goals and putting them into a formal plan.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.1 Conceptual Review**

##### **2.1.1 Concept of Corporate Governance**

Corporate governance is defined by Ford, Austin, and Ramsay (2020) as being about the management of business enterprises organized in corporate form, and the mechanisms by which managers are supervised and in Larcker, Richardson & Tuna, (2018), as "the set of mechanisms that influence the decisions made by managers when there is a separation of ownership and control". A common theme in these definitions is that, they focus on the actions of managers, a broader definition is that corporate governance is that it is a set of mechanisms that ensure a firm's assets are managed in an efficient way. These mechanisms are a set of structures, processes, cultures and systems through which objectives are set, and the means of attaining the objectives and monitoring performance are determined and companies are directed and controlled.

Corporate governance is a uniquely complex and multi-faceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis and solutions lie in multidisciplinary fields i.e. economics, accountancy, finance among others (Cadbury, 2016). As such it is essential that a comprehensive framework be codified in the accounting framework of any organization. In any organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. The health of the organization depends on the underlying soundness of its individual components and the connections between them.

According to Morck, Shleifer and Vishny (2019), among the main factors that support the stability of any country's financial system include: good corporate governance; effective marketing discipline; strong prudential regulation and supervision; accurate and reliable accounting financial reporting systems; a sound disclosure regimes and an appropriate savings deposit protection system.

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However they all have pointed to the same end, hence giving more of a consensus in the definition. Coleman and Nicholas-Biekpe (2020) defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. However, Mayer (2019) offers a definition with a wider outlook and contends that it means the sum of the processes, structures and information used for directing and overseeing the management of an organization. The Organization for Economic Corporation and Development (2018)

has also defined corporate governance as a system on the basis of which companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters.

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making. In expectation of such an improvement, the firm's value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty Imam, (2020).

Good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, which is another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationships with such firms, as the relationships are likely to be more prosperous, fairer, and long lasting than those with firms with less effective governance.

Implications for the economy as a whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at the firm level, the capital market will also be boosted and

become more developed, which is essential for sustained economic growth. At the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big businesses and political power may result in a more favorable business environment for smaller enterprises and more equitable income distribution, Iskander and Chamlou (2020).

### **2.1.2 Concept of Accounting Conservatism**

Conservatism is interpreted as representing the accountants' tendency to require a higher degree of verification to recognize good news as gains than to recognize bad news as losses (Basu, 2019). This interpretation reflects the asymmetrical verification requirements for gains versus losses and also describes conservatism from the point of gains and losses. While the definition as provided by Givoly & Hayn (2018) defined accounting conservatism as a selection criterion between accounting principles that leads to the minimization of cumulative reported earnings and net assets by lower revenue recognition and lower asset valuation.

Conservatism is the differential verifiability required for recognition of profits versus losses (Watts, 2020). Therefore, conservatism is having higher verification requirements for losses than gains. This interpretation, however, does not make a clear distinction between conservatism associated with the recognition of anticipated losses but not gains (ex ante sense) and conservatism associated with the asymmetric timely

recognition of actual losses and gains (ex-post sense). Some studies make this distinction and some studies, such as Chi, Liu, and Wang, DandagoAkintoye, Obisesan, Enigbokan, Adegun, Popoola, Offiah, & Ogunjubom. (2019), Pope, & Walker, M., (2013) categorized these two functions as ex-ante conservatism and ex-post conservatism, respectively. In this study, they are referred to as conditional and unconditional conservatism, respectively. Examples of conditional conservatism include the recognition of contingent losses but not gains and impairment of assets, while examples of unconditional conservatism include the use of First-in, first-out (*FIFO*) rather than Last in, first out (*LIFO*) for computing the cost of inventories and a depreciation method that, gives a higher depreciation expense.

Conservatism has traditionally been a fundamental characteristic of financial reporting (Sanjay, 2020). Empirical evidence shows a linkage between accounting conservatism and financial reporting quality. Young (2020) found that accounting earnings becomes more useful for reducing distortion in incentive contracts when measured conservatively than when measured aggressively. He concluded that accounting conservatism enhances the incentive value of accounting signals with respects the cost of agency.

Given that conservatism increases firm value by reducing agency and litigations costs, it is commonly considered as an indicator of earnings quality or a desirable property of accounting earnings (Garcia, Beatriz & Penalva 2019). Therefore, in other to

reduce managers' opportunistic behavior, owners require timely recognition of losses than for earnings.

Qintao and Xiaho (2019) shows that when firm can control the quality of financial information through non contractible action, an accounting policy that aggregates raw information in a biased fashion can increase the quality of financial reporting. The study takes into consideration the endogenous nature of the information generation process. That is, accounting system that functions as a classification system in the presence of uncertainty serves not only as an aggregation scheme ex post but also incites firms to improve the information quality ex ante. This result only holds if the objectives of standard setting include other consideration such as enhancing corporate control or facilitating litigation. However their study relies on the assumption that the average preference of investors can be captured by the behaviour of representative investor and also they do not study the general setting where different types of investors intend different uses of the same information.

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### **2.1.3 Measures of Conservatism**

The most popular measures of conservatism include net assets, earnings and accruals measure, and earnings-return relationship measure (Mohammed, 2019). **Net Assets Measure:** The market value of assets and liabilities comprises the net disparities in the assets of each period. However, all these disparities are not chronicled in the accounts and are not replicated on financial reports. According to the conservatism concepts, increasing assets' value (earnings) which is not adequately provable will not be documented; while their decreasing value with alike provability will be reduced. Feltham and Ohlson (2017) model is typically used to evaluate the assets at a level lesser than the real assets. This models comprise those considerations with low splendour of operating assets based on the supposition that the accounting devaluation is bigger than the economic depreciation.

Bior and Rayan (2017) used the ratio of book value to the market value. Taking other elements constant, using conservative accounting leads to reporting lesser net assets and lesser ratio of book value to market value (Watts, 2019).

**Earnings Measure and Accruals (Earnings to Accruals Ratio):** Conservatism documents that the earnings are more tenacious than the losses because the invulnerability upsurges in the value of the assets (earnings) which are not recognized when they occur. However, these upsurges will be understood during the upcoming periods by generating cash flows. The losses are not typically repeatable in future periods and they have less persistency than the earnings. Unpredictability of losses and persistency of the earnings and their disparities provide a gauge of conservatism. This irregularity behavior of conservatism with the profits and losses will lead to irregularity in realizing accruals.

As Givoly and Hayn (2018) articulate that conservatism causes the retained earnings to decay over time. Givoly and Hayn (2018) believe that the indication and the level of retained accruals over the time are some methods of conservatism. Taking other factors constant, clear constancy of the negative accruals (such as reserves) among the firms during a long period is an indicator of conservatism and the build-up rate of negative accruals designates the level of changes at the conservatism level during the time (Givoly & Hayn , 2018).

**Earnings-Stock Return Measure:** Stocks market worth inclines to show the fluctuations in the assets value at the time of manifestation; these fluctuations might be in form of diminution of assets' value or upsurges in their value. As a significance, it can be concluded that the stock return has a predisposition to be timely and hence, conservatism primes accounting losses to be realized more timely than earnings.

Accordingly, it is foretold that losses are more dependable with the stock returns than incomes.

Basu (2018) explained that stock return and accounting income incline to show losses of a same period, but the stock returns reflect the losses earlier than accounting income.

Basu (2018) used stock return to measure the news between earnings and stock return and found that the response of earnings to the bad news (negative stock return) is timelier than the response of earnings to the good news (positive stock return). He also showed that the persistency of the negative changes in the earnings is less persistent than their positive changes. He provided a measure to evaluate the conservatism in which there was a profit or loss viewpoint and is called timely asymmetry.

#### **2.1.4 Accounting Conservatism and Board Independence**

Board independence is a key dimension of corporate governance as it is concerned with the extent to which the board can be said to be objective. The independence of the board can be measured by the number of non-executive or outside directors on the board. The importance of outside directors has been recognized even at the level of policy, with codes of corporate governance giving a special attention to the need to have a reasonable proportion of them on the board of listed firms. Empirical evidence has shown that properly constituted boards with the right mix of non-executive directors tend to contribute an unbiased sense of judgment (Ilaboya & Iyafekhe 2020). The empirical relationship between board independence and accounting conservatism is still a

bourgeoning area of accounting research with several researchers now paying close attention to the nexus between both variables.

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Similarly, El-habashy (2019) investigate the corporate governance attributes that influence the level of accounting conservatism in Egyptian listed firms. A sample of the 40 most active non-financial companies collected in the period 2009-2017 was used for hypothesis testing. Panel regression models were used for data analysis. Givoly & Hayn (2019) index is used as conservatism measurement criteria.

In a cross sectional study, Joo (2019) reported more conservative firms operate with less inside ownership and small board size. On the contrary, Garcia, Beatriz & Fernando (2019), investigate whether firms with sound corporate governance shows

higher degree of conservatism than weak firms. They control for the endogenous nature of corporate governance and the fact that governance and conservatism may be simultaneously determined using a composite measure that incorporates the level of antitakeover protection and the level of CEO involvement and internal governance. Using a large sample of U.S firms during the period, they found that firms with stronger corporate governance provisions in place are more conservative. Their result is similar even after isolating the event that resulted in exogenous shock to corporate governance and the passage of the Sarbanes Oxley Act of 2002. They also observed causality from strong governance structures to conservatism and not vice versa. That is, strong corporate governance employs conservatism as a tool to fulfill its monitoring role. Their study is limited by the aggregation of governance structures across firms.

Garcia (2020) investigates this relationship in the Spanish context by utilising 69 non-financial Spanish firms from 1997 to 2018. They use a more extensive measure of corporate governance by aggregating the index incorporating the following board characteristics which are directors' denominations, board size, proportion of non-executive directors, independent directors, number of board meetings, CEO/Chairman duality, the existence of audit committee and the existence of a nomination/remuneration committee. They provide evidence which shows that firms with strong boards use conservative accounting numbers as a governance tool even in an institutional setting with low litigation risk. Similar to their U.S study, their research is limited by the aggregation of governance structures across firms.

### **2.1.5 Board Size and Accounting Conservatism**

Board size refers to the total number of directors on the board of each sample firm which includes the Chairman and CEO for each financial year. This includes outside directors, executive directors and non-executive directors. Board size seems to differ from one company to another. And the question of “what size of a board should be” seems not easy to answer. Because the right size of a board depends on many factors such as the size of the corporation, the depth and complexity of issues facing the corporation, the responsibilities that the board should carry out. This study focuses on evaluating the relationship between board size and accounting conservatism and the literature in this regards is quite revealing. For example, Sutathip, Nuchjaree and Sungworn (2020) examine whether corporate governance could be seen as an explanation for accounting conservatism in Malaysia and Singapore. This research used 389 samples, comprising 244 firms from Bursa Malaysia and 145 firms from Singapore Exchange, excluding financial firms. Data were analysed by using the multiple regression. The research results were explained with both notion of large and small board members on accounting conservatism.

Shiyanbola, Adegbe, Oyesola and Salawu (2019) investigated the effects of corporate governance on conservatism of quoted financial and non-financial firms in Nigeria. The study adopted ex-post facto research design using the population of 161 listed companies on Nigerian Stock Exchange at 31st December, 2017. Sample of 30 quoted financial and nonfinancial firms was purposively selected from 2003-2017.

Multiple regression analyses was used. The findings revealed that board size amongst other corporate governance variables had joint significant effects on conservatism of quoted financial and non-financial firms in Nigeria.

On the contrary, Akbar, Jalal, Morteza and Javadian (2018) investigated the relationship between corporate governance and conservatism in financial reporting of listed companies in Tehran Stock Exchange. In this study, to operationalize the conservatism coupled used Feltham and Ohlson (1995) and Givoly and Hayn (2000) model; and used board size, as proxy for corporate governance. To investigate this relationship used the multiple regression models. Findings of investigation of 146 companies (1259 firm-years) listed in Tehran Stock Exchange in the 2001 to 2012 by unbalanced Panel model representative, relation between conservatism and corporate governance was not significant.

Arguments in relation to large or small size of the board exist. In favour of small board size is that directors rarely criticize the policies of top managers and that this problem tend to increase with the number of directors (Sanda, Mikail, & Garba 2019).

In favour of larger boards is that they may be more constructive as they have more external linkage and the ability to extract critical resources such as funding and expertise, which leads to higher performance (Joo, 2019).

Joo (2019) found that board size is negatively associated with accounting conservatism while the Rahimah (2020) provides evidence which shows board size is

positively associated with conservative accounting. However in a study by Nor, Kamran and Xu (2019), they provide evidence that board size is not related to accounting conservatism in Malaysia.

### **2.1.6 Audit Committee and Accounting Conservatism**

The concept of audit committees differ according to the goals, functions, and responsibilities assigned to them. Al-Thuneibat (2020) defined it as “the committee that is composed of non-executive directors in the establishment”. The major goal behind forming the audit committee is to increase auditing quality and questioning of directors board. Arens (2020) defines it as “a group of persons selected from members of the board of directors who are responsible for retaining independence of the auditor”.

Many studies were concerned with analyzing qualities of audit committee as one of the tools of corporate governance, with many influences like controlling earnings management or improving financial reports, and earnings quality. Hamdan and Mushtaha (2019) studied the relationship between the possibility of the company receiving an audit clean report, and the characteristics of the audit committee of the industrial Jordanian companies listed in ASE. The findings of their study showed a positive impact for the size of the audit committee members on the report of external auditor. They also showed a negative impact for stock ownership of members of audit committee on the report of the external auditor. At the same time, the independence of (executive and non-executive) members of the audit committee or the number of meetings had no impact on the opinion of the external auditor. Stewart and Munro (2020) focused on the results of frequent

meetings of the audit committee. They found the following: The presence of audit committee, the number of its meetings, and the auditor's attendance for such meetings reduce audit risks.

As for the ability of the audit committee to control earnings management, the study of Saleh (2007) tried to evaluate the role of some qualities of the audit committee with regard to independence of committee members, its size, frequency of meetings, in addition to the experience and knowledge which members of the committee have to monitor management behavior. The practices related to earnings management of the general Malaysian joint-stock companies, the conflict between managers and external auditors might exist due to the choice of alternative accounting procedures related to earnings management. Some of the most important findings of the study are: absolute independence among members of the audit committee reduces the practices of earnings management in the Malaysian companies, the companies whose members of audit committee are distinguished for experience, financial knowledge, professionalism, in addition to frequent meetings of the committee have less practices of earnings management when compared to other companies.

### **2.1.7 Board Composition and Accounting Conservatism**

The composition of the board can be used as a tool for monitoring and alleviating the opportunistic behaviour of managers. In other words, boards that are mostly constituted of inside directors may lead to transfer of wealth to themselves instead of stakeholders. In a US study, Ahmed and Duellman (2020) found that high proportions of

independent directors were associated with high level of accounting conservatism. Also, they found that boards dominated by management is not effective to reduce agency conflict and thus does not employ more conservatism. Garcia (2020) a using aggregate index as a proxy for strong boards found a positive relationship between outside directors and accounting conservatism. They reported that strong boards of directors incorporate bad news significantly faster into earnings than weak boards. That is, accounting conservatism is utilized by independent directors to assist them in monitoring management.

The study of Mazlina, (2019) tried to test the relation between characteristics of the audit committee and those of the internal audit committee to evaluate the contribution of internal auditors in auditing financial statements. It conducted that through designing and distributing a questionnaire to internal executive auditors in (76) general Malaysian companies listed in the financial market. The most important findings were: there was a positive relation between the internal auditors evaluation regarding their contribution in auditing financial statements and three audit committee characteristics: rate of independence of its members, knowledge, and experience which the members have in the fields of accounting, auditing, and reviewing programs of internal auditor, results showed that the most effective audit committees and good resources regulating internal auditing tend to be positively related to the evaluation of internal auditors in their contribution to external auditing.

### **2.1.8 Managerial Shareholding and Accounting Conservatism**

Evidence on the use of insider shareholding in solving agency problem is mixed. Douglin & Song (2019) argued that management may manipulate earnings by choosing a reporting method that will maximize their own interest. This will lead to less conservative reporting, especially when the level of management ownership is higher and compensation is more closely related to performance. Their argument is supported with the outcome of their findings which shows a significant negative relationship between managerial ownership and accounting conservatism.

On the contrary, Joo (2019) supports the view that management owning shares in the firm may reduce the agency conflict, thereby aligning their interest with that of the shareholders. Using a sample of 716 Malaysian firms, he found that insider shareholding reduces the level of accounting conservatism in firms. Their result was contrary from their expectation that managerial ownership will improve reliability of financial reporting. Rahimah (2020) obtained similar result which show inside ownership is negatively related to accounting conservatism.

### **2.1.9 CEO Duality and Accounting Conservatism**

There are two views expressed by competing theories. While agency theory posits that CEO and the chairman roles be separated since the board responsibilities includes monitoring the management and the CEO, the stewardship theory views it otherwise. It argues that the CEO acting as the chairman improves performance as there is no information breakdown between the CEO and the board.

Rahimah (2018) found that joint leadership structure weakened firms governance, as it lead to earnings manipulation and higher fees. Ahmed and Duellman (2019) in a U.S study found no significant relationship between CEO/Chairmanship separation and accounting conservatism. Also, Rahimah (2011) studied the same relationship in the Malaysian context. The study utilized panel data on Malaysian data over seven years from 2001 to 2007, the result shows no evidence that CEO duality is associated with conservatism. In contrast to this, Wuchun (2019) found that firms with CEO acting as the chairman have a greater demand for accounting conservatism to make up for the weakness in sound corporate governance.

#### **2.1.10 The Link between Corporate Governance and Accounting Conservatism**

A firm is a nexus of contracts and hence the link between corporate governance and conservative accounting stems from the important role of each in facilitating efficient contracting. These contracts exist to mitigate agency problems associated with the separation of ownership and control within the firm. One of the most important contracts is the contract between shareholders and managers of the firm. Since managers may act on maximizing their own wealth rather than shareholders' wealth, accounting conservatism mechanisms are put in place to mitigate these problems (Watts & Zimmerman 2020).

The board of directors plays a central role in corporate governance, an effective board is likely to demand that managers adopt conservative accounting practices to prevent overcompensation and to reduce the probability and magnitude of corporate

collapses; since managers tend to be optimistic. Therefore, board independence is an important element of board effectiveness. Since boards need to be independent of the managers in order to monitor them effectively, hence, boards will be motivated to demand a conservative accounting to reduce litigation risks.

## **2.2 Theoretical Framework**

### **2.2.1 Neoclassical Theory**

The neoclassical theory propounded by John Maynard Keynes (1936) postulates that a firm is an abstraction, a perfect form of business, whose existence is explained exclusively by the purely economic motive of generating profit. The neoclassical firm's objectives as thus principally profit-maximizing or cost minimizing.

However, according to neoclassical theory, a firm is a corporate entity operating in an exogenous environment with many factors which lie beyond the firm's control. This by implication means that profit as a motivation for the firm's growth and the purpose of its existence, is determined by external factors beyond the firm's control (Sangosanya, 2011, citing Bernadette and David, 2005). The dissatisfaction in the 1930s with the neoclassical theory's simple conception of the firm as a device which transforms atomistic inputs into marketable outputs gave rise to a number of alternative perspectives. One such perspective took a legal, economic view of the firm in order to discover key

aspects of its internal structure. This in turn formed the basis of the managerial theory of the firm.

### **2.2.2 Managerial Theory**

The managerial theory propounded by Baumol (1967) explains that one of the major reasons why managers are hired is to increase sales or maximize revenue rather than for profit maximization. The managerial theory centres on the function of a manager as revenue maximization agent. The theory holds that firms should aim to increase their output and to capture the largest market share, which in turn will result in increased sales. Critics of the managerial theory argue that cost minimization and profit maximization should be a manager's principal function, while some argue that the managerial theory is simply a modernized version of the neoclassical theory.

### **2.2.3 Penrose Theory**

The penrose theory propounded by Milton Penrose (1995) argues that there will likely be "managerial limits to firm growth". Penrose postulated that management is a team effort in which each employee deploys specialized, functional skills as well as more highly-efficient team-specific skills, which enable them to individually and collectively coordinate the many activities of the firm in a coherent manner. She argued that firms had no long-run determinant or optimum size, but only a limitation on current-period growth rates. However, a major criticism of the Penrose theory is that, contrary to its postulations that the adjustment costs are variable rather than fixed, the observed and direct indications of adjustment costs show that they are fixed in nature and not variable. Furthermore, it is difficult to reconstruct Penrose's argument on managerial limits to

growth, and this means that the cost of expanding the management team is independent of the number of new managers to be recruited into the team.

#### **2.2.4 Optimal Firm Size Theory**

The optimal firm size theory propounded by Haydes (1986) as a response to the inadequacies of the managerial limit theory, postulate that firm size is strongly dependent on a number of considerations. Such factors include the market structure in which the firm operates, in other words whether it operates in a perfectly competitive market or an imperfectly competitive one (e.g. monopoly, oligopoly, or monopolistic competition). The major conclusion of the optimal firm size theory is that small companies grow faster than larger companies until they reach the minimum efficient scale (MES) point of production. Similarly, if firms have market power (i.e. where there is imperfect competition), their optimal size may deviate from this optimal cost position, and if there are economies of scope, such deviations may be more noticeable. However, in this situation, a firm's ability to grow depends on its innovations, in other words, the limits to a firm's potential growth are largely determined by the demand for its unique product rather than by cost considerations.

#### **2.3 Empirical Review**

Garcia, Garcia and Penalva (2017) using aggregate index as a proxy for strong boards found a positive relationship between outside directors and accounting conservatism. The study employed correlational and ex-post facto research design for the period 2011 to 2015. The study employed secondary sources of data obtained from the annual reports of sampled firms. They reported that strong boards of directors incorporate

bad news significantly faster into earnings than weak boards. That is, accounting conservatism is utilized by independent directors to assist them in monitoring management.

On the contrary, the determinants of accounting conservatism using accrual-based measure and data from 2001 to 2017 in China was investigated by (Donglin, & Song, 2019). The study made use of pooled OLS, fixed effects, Random effect and generalized method of moments. They found that a higher degree of leverage, low level of control of ultimate shareholders, and a low level of management ownership lead to conservative reporting. They provide evidence in support of their argument that management incentives to comply with standards significantly influence the level of conservative accounting reporting. Their findings revealed that board independence does not have any significant effect on conservative accounting.

Also, using descriptive and regression. Analysis, the finding of the studies conducted by Nasr and Ntim, (2017) indicates a significant positive relationship between board independence and accounting conservatism. Furthermore, firms with a high level of independent directors are less likely to commit a fraud in the presentation of financial statements, to restate earnings and manage earnings and also experience a higher CEO turnover.

The empirical evidence on the link between the size of the board and conservative accounting is mixed. For example, Kiel and Nicholson, (2013); Ball, and Shivakumar, (2015), board size is negatively associated with accounting conservatism. In the work of

Joo (2019), Nasr and Ntim, (2017), while Chi, Liu, & Wang, (2019) carried out their study on Taiwan listed firms and found out that board size and CEO duality have negative and positive significant relation with conservatism. The mixed result could be due to the fact that, small boards are normally easier to coordinate and have fewer problems. However, larger boards are likely to have more experienced directors whilst allowing directors to be more focus on their task at hand.

Garcia (2020) investigates this relationship in the Spanish context by utilising 69 non-financial Spanish firms from 1997 to 2018. They use a more extensive measure of corporate governance by aggregating the index incorporating the following board characteristics which are directors' denominations, board size, proportion of non-executive directors, independent directors, number of board meetings, CEO/Chairman duality, the existence of audit committee and the existence of a nomination/remuneration committee. They provide evidence which shows that firms with strong boards use conservative accounting numbers as a governance tool even in an institutional setting with low litigation risk. Similar to their U.S study, their research is limited by the aggregation of governance structures across firms.

Shiyanbola, Adegbe, Oyesola and Salawu (2019) investigated the effects of corporate governance on conservatism of quoted financial and non-financial firms in Nigeria. The study adopted ex-post facto research design using the population of 161 listed companies on Nigerian Stock Exchange at 31st December, 2017. Sample of 30 quoted financial and nonfinancial firms was purposively selected from 2003-2017.

Multiple regression analyses was used. The findings revealed that board size amongst other corporate governance variables had joint significant effects on conservatism of quoted financial and non-financial firms in Nigeria.

Hamdan and Mushtaha (2019) studied the relationship between the possibility of the company receiving an audit clean report, and the characteristics of the audit committee of the industrial Jordanian companies listed in ASE were analyzed using the pooled OLS, fixed random effect models and the granger causality test. The findings of their study showed a positive impact for the size of the audit committee members on the report of external auditor. They also showed a negative impact for stock ownership of members of audit committee on the report of the external auditor. At the same time, the independence of (executive and non-executive) members of the audit committee or the number of meetings had no impact on the opinion of the external auditor.

## **2.4 Summary of the Review**

Its was seen that Garcia, Garcia, & Penalva (2017) using aggregate index as a proxy for strong boards found a positive relationship between outside directors and accounting conservatism. They reported that strong boards of directors incorporate bad news significantly faster into earnings than weak boards. That is, accounting conservatism is utilized by independent directors to assist them in monitoring management.

On the contrary, the determinants of accounting conservatism using accrual-based measure and data from 2001 to 2006 in China was investigated Donglin, & Song, (2019).

They found that a higher degree of leverage, low level of control of ultimate shareholders, and a low level of management ownership lead to conservative reporting. They provide evidence in support of their argument that management incentives to comply with standards significantly influence the level of conservative accounting reporting. Their findings revealed that board independence does not have any significant effect on conservative accounting.

This present seeks to join the literature in espousing the relationship between corporate governance and accounting conservatism, within the context of the Nigerian manufacturing industry. We also bring into the mainstream conversation of corporate governance the complementarily of hindsight, oversight, foresight, and insight in broadening our understanding of and/or shaping corporate governance practices.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Research Design**

In order to corroborate with the stated objectives, we shall employ descriptive research design. This study shall use data collected from the periods ranging from 2015-2021, spanning a period of six years. This is in view of the fact that the objectives of this study involve the testing of hypothesis and making inferences based on the findings.

#### **3.2 Description of Population of Study**

In order to successfully analyze the link between corporate governance and accounting conservatism among listed manufacturing firms in Nigeria with a study of Nigerian food and beverages industry this research study made use of Nestle company, Nigeria Bottling company, Unilever Nigeria, Dangote Group, Dansa foods Limited and Cadbury Nigeria plc as the population of the study and it covers a period of six years from 2015-2021.

### **3.3 Sample Size**

Based on the objective of the researchers work and in line with the sincere effort of the researcher to obtain a sample that would be a good representation of the population of the study, the researcher thought it wise to use Nestle company, Nigeria Bottling company, Unilever Nigeria, Dangote Group, Dansa foods Limited and Cadbury Nigeria plc as the sample size and it covers a period of six years from 2015-2021.

### **3.4 Sampling Techniques**

The researcher will make use of probability sampling on this work that involves simple random sampling.

### **3.5 Sources of Data Collection**

The source of data used in this research is secondary data, the data used for this study are annual times series from 2015– 2021. They are sourced from Nestle company, Nigeria Bottling company, Unilever Nigeria, Dangote Group, Dansa foods Limited and Cadbury Nigeria plc Annual Reports.

### **3.6 Method of Data Presentation**

The available annual financial statements and other data which are secondary in nature were obtained from Nestle company, Nigeria Bottling company, Unilever Nigeria, Dangote Group, Dansa foods Limited and Cadbury Nigeria plc annual reports from 2015-2021 and data collected were presented with tables.

Time series econometric shall be employed, the classical linear regression model that will use the ordinary least square (OLS) method being the most popular and widely used among the variance time series econometric techniques.

### 3.7 Model Specification

This model will be used to estimate and examine corporate governance and accounting conservatism among listed manufacturing firms in Nigeria.

To test for the hypotheses of this study, the functional model is specified as follows;

ACONS = f (BOI, BOS, ACI). This is mathematically expressed as:

$$ACONS = \beta_0 + \beta_1 BOI + \beta_2 BOS + \beta_3 ACI + U_t \dots\dots\dots \text{model}$$

ACONS = Conservative Accounting

BOI = Board Independence

BOS = Board Size

ACI = Audit Committee Independence

$\beta_0$  = the interception of the model

$\beta_1$  &  $\beta_2$  &  $\beta_3$  = the coefficient of the independent variables

$\mu$  = error term that is used to capture other variables, that are not included in the model. It is expected to be purely random.

### 3.8 Measurement of Variables

The Ordinary Least Square (OLS) single equation method is the estimation procedure adopted in the study. This is preferred because it is easy to understand, simple in its Computational procedure and parameter estimation. It also possesses the properties of best, linear, unbiased estimator (BLUE), which are consistent and sufficient. The Microsoft Excel and E-view computer software package are used for this analysis.

<b>Variable</b>	<b>Abbrevia tion</b>	<b>Measurement</b>
Accounting Conservatism	ACONS	Measured based on an accrual-based measure of conservatism following Givoly and Hayn (2000). (net income before extraordinary item plus depreciation expense less cash flows from operations averaged, over 3 years by total assets and centered around year
Board Independence	BOI	Measured as a proportion of non-executive directors to the total number of directors on the board.
Board Size	BOS	Measured as total number of directors on the board
Audit Committee Independence	ACI	Profitability of firm

## **CHAPTER FOUR**

### **DATA PRESENTATION AND ANALYSIS**

#### **4.1 Data Presentation**

Table 1 presents the summary of the descriptive statistics for the dependent and independent variables for 6 observations. For the firms valuation it shows that ACONS has a mean value of 25.956 and a standard deviation of 2.7513. The maximum in ACONS is 30.4836 while the minimum is 22.8019.

For the corporate governance (a measure of board independence, board size and audit committee independence) the variable has a mean value of 184.635 and a standard deviation of 228.069. The other two variables have comparably the same mean values of 29.5470 and 25.763 and standard deviations of 0.3579 and 2.0129 respectively.

The table shows that the data used in the estimation of the parameters of the model are significantly normally distributed. This is implied by the probability values of

Skewness and Kurtosis of nearly all the variables which are less than 0.05. This connotes that the studied years are not dominated by years of any particular extreme values.

**Table 1 Descriptive Statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max	Pr(Skewness)	Pr(Kurtosis)
<b>ACONS</b>	8	25.95605	2.751321	22.80189	30.48355	0.0089	0.0364
<b>BOI</b>	8	184.6347	228.0689	1.587821	852.4481	0.0014	0.0148
<b>BOS</b>	8	29.54703	.3578708	28.82246	29.93911	0.0013	0.0039
<b>ACI</b>	8	25.763	2.012932	22.16646	28.45221	0.0071	0.0062

Source: Computed from Various Web sites Using STATA 14

## 4.2: Data Analysis

### Correlation Analysis

Table 2: Correlation Matrix

	<b>ACONS</b>	<b>BOI</b>	<b>BOS</b>	<b>ACI</b>
<b>ACONS</b>	1.0000			
<b>BOI</b>	0.3851	1.0000		
<b>BOS</b>	0.4758	0.2498	1.0000	
<b>ACI</b>	0.2477	0.7584	-0.0123	1.0000

Source: Computed from Figures Obtained from Various Web sites Using STATA 14

Table 2 shows that the measure of activity, conservative accounting has positive correlations with the various other variables used in the study. That is, ACONS is

positively correlated with BOI, BOS and ACI which all measures of corporate governance.

The table shows that no two of the variables are perfectly correlated or nearly so. Thus, the problem of multi-colinearity is absent in these models.

### **Regression Analysis**

Tables 3 and 5 show moderate R-squared values of 0.61665 and 0.2264, respectively. These moderate values of the R-squared statistics suggest that there are some other variables in explaining changes in the dependent variables. For the models, the p-values of the Chi squared-statistics (0.0005 and 0.0395) show that the models overall are suitable for estimating the stated models.

### **4.3 Testing of Hypotheses**

#### ***Test Statistic***

The statistical tool used in testing the stated hypotheses is the ordered logistic regression test of the ordinary least squares (OLS) procedure which uses the individual significance test (t-test) and the overall significance test (Chi squ-test). The goodness of fit of the model is tested using the coefficient of determination (R-squared-statistic). The estimation of these statistics is done using the STATA 14 computer software.

#### ***Significance Level***

The level of significance adopted in this study in testing the stated hypotheses of this study is 5%. This level is usually considered adequate for studies in management and other behavioural sciences.

***Decision Rule***

The critical p-value used in these tests is 0.05. Thus, the researcher accepts a given alternative hypothesis as being accepted if calculated p-value is less than or equal to 0.05, otherwise the researcher accepts the null hypothesis that there is no significant effect.

***Hypothesis 1***

**H<sub>0</sub>:** There is no significant relationship between board independence and conservative accounting.

**H<sub>1</sub>:** There is a significant relationship between board independence and conservative accounting.

***Computation***

The test statistic is computed by STATA 14 software and the results are as shown in Table 3.

**Table 3: Regression Results on board independence and conservative accounting**

Source	SS	Df	Number of obs =	7
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	F(2, 16) =	12.87		
Model	577301.909	2	Prob > F =	0.0005
Residual	358975.642	16	R-squared =	0.6166
			Adj R-squared =	0.5687
Total	936277.552	18	Root MSE =	149.79
<b>BOI</b>	<b>Coef.</b>	<b>Std. Err.</b>	<b>t</b>	<b>P&gt;t</b>
<b>BOS</b>	17.41775	13.24489	1.32	0.007
<b>ACI</b>	80.0289	18.10342	4.42	0.000
<b>_cons</b>	-2329.246	507.3976	-4.59 0.000	

Source: STATA 14 Computations

## CHAPTER FIVE

### SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary of Findings

This study examined corporate governance and accounting conservatism among listed manufacturing firm in Nigeria, the following are the findings of the study;

- i. It was discovered that there is a positive and significant relationship between board independence and conservative accounting
- ii. It was observed there is a positive and significant relationship between board size and conservative accounting

- iii. It was established that there is a positive and significant relationship between audit committee independence and conservative accounting.

## **5.2 Conclusion**

In conclusion, It was observed that there is positive and significant between Corporate Governance (CG) and Conservative Accounting of companies in Nigeria and this observation concur with studies of Garcia, Garcia, & Penalva (2017), Nasr, & Ntim, (2017), Kiel & Nicholson, (2013); Ball, & Shivakumar, (2015), Joo,. (2019) & Chi, Liu, & Wang, (2019).

Furthermore, companies with a high proportion of independent directors are less likely to restate or manipulate earnings or publish fraudulent financial statements. The agreement between the company's shareholders and managers is one of the most significant contracts. Accounting conservatism techniques are implemented to reduce these risks since managers may focus on maximizing their personal wealth rather than the value of shareholders.

## **5.3 Recommendations**

Based on the findings, the study deems it fit to make useful suggestions on a way forward.

- i. It was advised that companies increase the number of nonexecutive members on their boards based on the study's results and conclusions, since this can produce the certainty required for better financial reporting.

- ii. Companies should have a limited board size to improve conservative reporting. While companies ought to have more non-executive directors on their audit committee in order to raise the standard of their reports.
- iii. The study recommends the need for corporate boards to reflect and represent all significant stakeholder interests so that board decisions will not be skewed unhealthily. Given, that there are certain scenarios where it is less risky for companies to be conservative and may be in the best interest of the organisation, it is possible that boards that show less capacity for heterogeneity in opinions and views can over-stretch the justifications for conservatism to actually become a tool for distortions of accounting information and reducing earnings quality.

#### **5.4 Suggestions for Further Study**

Despite the researcher's aforementioned viewpoints, this study explored corporate governance and accounting conservatism. In light of the aforementioned, it may be possible to conduct a future study to explore and analyze corporate governance on accounting conservatism using other corporate governance variables or mechanisms which you can recommend from a few Nigerian deposit money institutions throughout the epidemic period.

#### **5.5 Contribution to Knowledge**

In contributing to knowledge, this research will help to improve how accounting conservatism is used to indicate the empirical results or to identify some issues and to

debate in emerging market. Furthermore, this research will play an important role in the accounting area and accounting research development market, as well as will add to the overall literature about accounting conservatism. In line with prior research, this research work will show the effects of corporate governance on accounting conservatism, to support and enhance the academic study.

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### Appendix I

Variable	Obs	Mean	Std. Dev.	Min	Max	Pr(Skewness)	Pr(Kurtosis)
<b>ACONS</b>	8	25.95605	2.751321	22.80189	30.48355	0.0089	0.0364
<b>BOI</b>	8	184.6347	228.0689	1.587821	852.4481	0.0014	0.0148
<b>BOS</b>	8	29.54703	.3578708	28.82246	29.93911	0.0013	0.0039
<b>ACI</b>	8	25.763	2.012932	22.16646	28.45221	0.0071	0.0062

Source: Computed from Various Web sites Using STATA 14

2: Correlation Matrix

	<b>ACONS</b>	<b>BOI</b>	<b>BOS</b>	<b>ACI</b>
<b>ACONS</b>	1.0000			
<b>BOI</b>	0.3851	1.0000		
<b>BOS</b>	0.4758	0.2498	1.0000	
<b>ACI</b>	0.2477	0.7584	-0.0123	1.0000

## Appendix II

Source	SS	Df	Number of obs =	7
	F(2, 16) =	12.87		
Model	577301.909	2	Prob > F =	0.0005
Residual	358975.642	16	R-squared =	0.6166
			Adj R-squared =	0.5687
Total	936277.552	18	Root MSE =	149.79
<b>BOI</b>	<b>Coef.</b>	<b>Std. Err.</b>	<b>t</b>	<b>P&gt;t</b>

<b>BOS</b>	17.41775	13.24489	1.32	0.007
<b>ACI</b>	80.0289	18.10342	4.42	0.000
<b>_cons</b>	-2329.246	507.3976	-4.59 0.000	