

ACCOUNTING CONSERVATISM AND PROFITABILITY OF LISTED FIRMS IN NIGERIA

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Abstract

Accounting conservatism reinforces and influences regulation to increase legal liability. The avoidance of inappropriate distribution claims by stakeholders as dividends. That has been an important contracting reason for conservative accounting. Measured in asymmetric timeliness and default adjusted Basu as independent and returns on equity as the dependent variable. The panel presents a multiple regression analysis of 11 years of data fixed-effect model as a tool for 2010 – 2020. The Stata version 13 statistical software extracted the secondary source from annual reports of listed firms in Nigeria. The study reported a positively significant relationship between asymmetry timeliness and profitability. The results reveal an unsustainable positive and considerable relationship amongst defaults adjusted Basu and profitability in Nigerian listed firms. The study finding discloses that conservative accounting Basu practice is an efficient management tool in controlling agency problems. Conservatism principle plays a vital role in presenting the true nature of profitability of an entity. The accounting regulatory framework advised to makes conservatism principle known to shed its potentiality to the managers, stakeholders, staff, and interested bodies. To act conservatively in preparing their profitability, monitoring, and decision-making of a firm.

Keywords: Accounting Conservatism, Asymmetry Timeliness, Default Adjusted Basu, profitability, Nigerian listed firms.

1. Introduction

The accounting conservatism principle presents the true nature of the profitability of an entity. The general explanation of accounting conservatism is essentially by the International Accounting Standards Board (IASB). Conservatism has become a degree of care in judgmental activity estimating as necessary under uncertain circumstances. Assets and income must not be exaggerated, while liabilities and expenditures must not underestimate IASB 1987 Para. 37; (Lip & Wiley, 2011; Teymouri & Sadeghi, 2020). Nonetheless, as compared to other conceptions of practice in the field of accounting, conservatism lacks a well-articulation and as yet widely agreed-upon meaning.

The series of literature about the financial crisis mostly led firms to discontinuities and collapses due to the exceeded dividends. The high profit discloses as the benefits of firms. Endangered firms in exceeding dividends result from reporting an inflated profit in their profitability for inducing external investors. Lin & Wun (2016) examined accounting conservatism as a technique for evaluating the validity of accounting rules. Conservatism projects to boost the profitability of listed companies via rapid recognition of revenue loss in the form of operational costs in the income statement.

The significance of this study displays an additional room of accounting research knowledge in the principle of conservative accounting. In the notion of conventional accounting, the profitability of listed enterprises in Nigeria is also explicit. The research also offers a new accounting analysis to explain the idea of conservative accounting. As shown, accountants tend to require a greater degree of proof to recognize positive information than bad news. The profitability of listed companies in Nigeria in the financial statements. Adopted Basu (1997) standard measures and default adjusted Basu measures (Wang, 2009) as conservatism. Which tremendously supported by kinds of the literature on accounting conservatism (Khalilov and Osma, 2020; Al-hroot et al., 2017; Cheng et al., 2017; Alkurdi et al., 2017; Sana'a et al., 2016; Mousa, 2014; Teymouri & Sadeghi, 2020; Khan & Ali, 2015) to mention few among others.

2. Review of related studies

The outstanding literature in accounting overemphasized that accounting conservatism is the oldest and the utmost important principle of accounting worthy of practice in an entity (Wang, 2009; Embring and Wall, 2012; Affes et al., 2016). Based on this views, several studies have endorsed accounting conservatism for the endless continuation and sustainability of business in different economic of profitability (Teymouri & Sadeghi, 2020; Harakeh, 2017; Olyhoek & Carstens, 2017; Marzuki et al., 2016; Allali, 2010; Callen et al., 2016; Rebecca et al., 2016; Kim, 2014; Wang et al., 2009; Sultana, 2015; Sultana & Zahn, 2015; Wend, 2010; Kim, 2014; Science and Talebnia, 2016; Jieying Zhang, 2005; Bello, 2014; Garrison and Garrison, 2015; Sanna, 2011; Li, 2009; Garrison and Garrison, 2015; Kravet, 2014; Li, 2011; Liu, 2010; Hijmering, 2012; Bouchani & Ghanbari, 2015; Hassani & Rahmani, 2014; Sana'a, 2016; Okeke, 2015; Al-hroot et al., 2017; Kootanaee et al., 2013; Al-Sraheen, 2016; Khaddafi and Pravita, 2015; Kim and Pevzner, 2010; Kim, 2010; Embring & Wall, 2012; Ghordati & Rad, 2014; Wang, 2015; Chen et al., 2013) to mention few among others.

Uncertainty, some studies define conservatism as the gate to an underestimate of book value. Compared to the equity and the asset market value (Andr, et l., 2013; Asri & Atma, 2015; Bushman, & Piotroski, 2004; Dumontier, 2015; Kim, et al., 2013; Rebecca, Felix, & Onyeisi, 2016; Sanna, 2011; Science, & Talebnia, 2016; Kim, Li, Pan, & Zuo, 2013; Taylor, Gary, 2014). However, the critical question in assessing the profitability impact of accounting conservatism is how it affects equity income through persistence and the elimination of asymmetric information.

Moreover, the kinds of literature support the enhancement of the standards in financial reporting. The conservatism mitigates profitability in agency problems and links managerial investment decisions (Teymouri & Sadeghi, 2020; Alkurdi et al., 2017; Wang, 2015; Harakeh, 2017). The uncomfortable of the investors with the managers in giving a timely account of the bad news through reliability. The

credibility of information shared with them about economic losses instead of positive news and economic benefits (Hamdan, Kukrija, Awwad, and Dergham, 2012; Dhaliwal, 2008).

According to Khaddafi & Pravita (2015), conservatism is an effort to improve firms' financial reports. The concept of conservatism, construct premise businesses in careful measurement, is documented in the future face of economic uncertainty. In previous research, conservatism has increased the debt structuring value of the accounts and reduced inequalities between lenders and borrowers and lenders. In particular, the work of (Tan, 2013; Lee et al., 2015; Khalilov and Osma, 2020; Chen et al., 2013), among others. Therefore, we posed the following research questions: Does Basu's standard conservative accounting contribute to the sustainable profitability of quoted firms in Nigeria? To what influence does the conservative accounting of the default adjusted Basu model affect the profitability of listed firms in Nigeria?

This study fills the posed gaps and makes initial efforts to examine the influence of accounting conservatism on the sustainable profitability of listed firms in Nigerian. The main objective of this study is to determine the influence of accounting conservatism in different measures and the sustainable profitability of listed firms in Nigeria. In line with the objective above of the article, the subsequent hypotheses articulated in the null form:

H₀₁: There is no substantial effect of standard Asymmetry timeliness on the profitability of Nigerian listed firms.

H₀₂: There is no notable effect of Default Adjusted Basu on the profitability of Nigerian-listed firms.

The study observed the influence of accounting conservatism on the sustainable framework of profitability of listed firms of Nigeria. The study covers the periods of (11) years of 2010 to 2020. The number of 429 observations of 39 selected firms from the population of 114 corporations listed in the Stock Exchange of Nigeria. Firms service in nature considered for sample size, using a purposive nonprobability sampling Technique, respectively. Profitability in exchange for return on equity measure as a dependent variable of the research. The independent variables of the study are asymmetry timeliness measures (Basu et al., 1997) and Default Adjusted Basu (DAB) measurement of accounting conservatism (Wang et al., 2009). Subsequently, the study also employs the control variables of firm size and leverage to distinguish among the firms.

3. Methodology

This research is a quantitative paradigm of positive nature and utilized for secondary source data. The design of the corresponding study is used in the subsequent analysis as independent variables to describe the statistical relationship between profitability proxy by equity return and asymmetric timeliness standard measurement proxies of accounting conservatism by (Basu et al., 1997) and Default Adjusted Basu measures by (Wang, 2009). A regression analysis applies to evaluate the connection between the model variables. This research comprises 39 of the 76 eligible companies listed in the Nigerian Stock Exchange (NSE), conducting 429 observations from 2010 to 2020.

Independent Variables

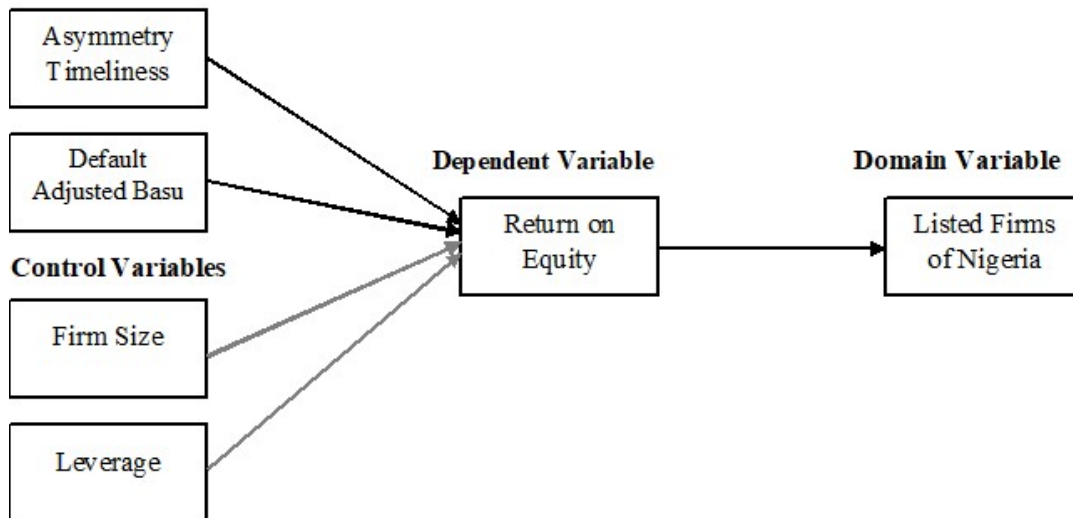


Figure 1: Conceptual framework of accounting conservatism on profitability

The measuring of dependent variable: This study adopted Affes et al., (2016) model for measuring return on equity (ROE) regarding measuring profitability, which has been considered the net income divided by total shareholders equity. The study adopted independent variables of Basu et al., (1997) standard model, which widely researchers used to proxy accounting conservatism and, subsequently, opposed to the Basu's standard model devised as Default Adjusted Basu measures (Wang, 2009). Stressing the possible advantage of conservative accounting is that knowledge asymmetry risk among managers and equity investors reduces. Contrary to the premise of Wang (Basu et al., 1997), accounting conservativeness metrics tend to need a higher verification point to differentiate good news from profits and awful news from losses.

Sample size and sampling technique

In the course of this study, it is not possible to study the whole population. Some elements of the firms are therefore selected as representatives and thus constitute the sample. Thirty-nine (39) non-financial firms listed on NSE consider as sample size. The judgmental and purposive sampling Technique uses 76 firms as the population of the study. The justification for choosing Oil and Gas (8), Consumer Goods (16), Construction and Real estate (3) and Industrial Goods (12) is due to the argumentative activities of these companies are directly impacting negatively on the conservative principle and also due to their specific core service in nature of the business, making a considerable profit from their operation in Nigeria and risk profile (Okeke et al., 2015). The data from the sampled companies covered 11 years (2010 to 2020) and transformed into specific attributes of our variables for the number of years the research covers, which comprises several 429 observations, respectively.

Table 1: Variables measurement

Variable	Variable Nature	Proxy(ies)	Measurement	Author(s)
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Profitability	Dependent Variable	ROE	Net income divided by total equity capital	(Heikal, Khaddafi, & Ummah et al., 2014; Okeke, 2015; Affes et al., 2016)
Asymmetry Timeliness	Independent Variable	AT	Change in earnings per share divided by change in opening stock market price	(Basu et al., 1997)
Default adjusted Basu	Independent Variable	DAB	Net interest income divided per market value (debt + equity)	(Wang et al., 2009)
Firm size	Control Variable	FSIZE	Natural logarithm of total assets	(Hassan et al., 2017; Sultana et al., 2015)
Leverage	Control Variable	LEV	Total debts split into total assets	(Harakeh, 2017; Kang et al., 2017)

Source: Extracted from series of literature, 2021

Model Specification

The design model for the research is as follows:

$$ROE_{it} = \alpha + \beta_1 AT_{it} + \beta_2 DAB_{it} + \beta_3 FSIZE_{it} + \beta_4 LEV_{it} + \varepsilon$$

Where:

ROE = Return on Equity used to proxy profitability of profitability calculated as Net income divided by equity capital, as the dependent variable i for firm and t for the period/time/year.

A = Constant value.

β_1-4 = coefficient of the independent variable.

AT = Accounting Conservatism (Asymmetry Timeliness) standard Basu 1997 measures calculated as a change in earnings per share over a change in opening stock market price i for firm and t for the period/time/year as an independent variable.

DAB = Accounting Conservatism (Default Adjusted Basu) measures by Wang 2009 calculated as net income before interest divided in market value (equity + debts) i for firm and t for the period/time/year as an independent variable.

FSIZE = firm size calculated as the natural log of total asset, i for a firm, and t for the period/time/year as a control variable.

LEV = firm leverage considered as the total debt split into total assets i for firm and t for the period/time/year as a control variable.

ε = Error term. Non-operating

4. Result and discussion

4.1 Descriptive statistics

The findings of the analysis of the collected data for the research. The part starts with the descriptive data statistics given as follows in Table 2.

Table 2: Descriptive statistics

Variables	Mean	SD	Min	Max	N
ROE	17.111	53.959	-707.87	228.83	429
AT	0.1877	0.8337	-3.33	6.25	429
DAB	0.1309	0.4912	-6.14	4.24	429
FSIZE	1.7793	0.9055	-0.45	3.73	429
LEV	62.735	19.475	-41.45	100.3	429

Source: Stata 13 Output, 2021 (Appendix II)

Table 2 shows the descriptive statistics of the fitted model. The data set contains 429 observations for the 39 selected firms in NSE over the study period of 11 years. The independent variable measures against the dependent variable. The dependent variable is the return on equity. The model has a mean value of the return on equity class 17.111, with a count standard deviation value of 53.959. The average mean value of the return on equity is 17. The outcome result indicated that a return on equity of listed corporations in Nigeria deviates slightly from the mean value. The minimum mean value of the return on equity of the listed firms is -707.87. The maximum mean value of the return on equity is 228.83K. This outcome implies that some firms made losses in some financial years, while others performed well.

In the model of conservatism measured as audit independent, Basu 1997 has the mean value of 0.1877, with a count standard deviation value of 0.8337, which deviates from the mean slightly and has a minimum of -3.33 and a maximum of 6.25. This outputs attributes to the variation in the audit independent of selected firms in Nigeria. In this model, conservatism, adjusted by default (Wang et al., 2009), is 0.1309 in mean and 0.4912 in standard deviation. The default deviation is more significant than the average and may explain the losses caused by some sample firms. The mean difference for a model business size is between 1.779 and 0.9055, with a minimum size of -0.45 and a maximum length of 3.73. The leverage model has an average value of 62,735 and a sampling rate of 19,475 due to total debt split into tangible assets. This output indicates a significant shift in leverage values in Nigeria's selected businesses. The lowest number is -41.45. Similarly, the highest is 100.30.

4.2 Correlation analysis

In this part, the Pearson correlation coefficients of the research variables are given as follows in Table 3.

Table 3: Correlation matrix

Variables	ROE	ATBASU	DAB	FSIZE	LEV
ROE	1.0000				
ATBASU	0.0552	1.0000			
DAB	0.2022	0.0181	1.0000		
FSIZE	0.0509	-0.0382	0.0995	1.0000	
LEV	-0.0855	0.0203	-0.0836	0.0162	1.0000

Source: Stata 13 Output, 2021 (Appendix II)

The results in Table 3 show the correlation coefficients among the independent variables conservatism measured as Audit independent Basu 1997 and conservatism measured as Default Adjusted Basu by Wang 2009, and control variables of firm size, leverage against dependent variable proxy as ROE of the sampled firms in Nigeria. The table demonstrates a favourable link between asymmetry timeliness (ATBASU) and profitability proxy in the 0.0552 correlation coefficient model as a return on equity (ROE). This connection indicates that caution in accounting has a favourable impact on profitability. Similarly, the table findings show the positive link between the Return on Equity (ROE) profit and the Adjusted Basu Default (DAB) with a correlation coefficient of 0.2022. The finding means that the rise in conservatism leads to an increase in equity return. Then it has been demonstrated that the model is suited for the research.

4.3 Regression results

Table 4: Fixed effect model regression coefficients

Variables	Coefficients	t-values	P-Values
ATBASU	5.7862	1.84	0.067
DAB	25.547	4.64	0.000
FSIZE	-38.80	-4.11	0.000
LEV	-0.288	-1.80	0.072
CONSTANT	99.783	4.98	0.000
R ² Within	0.1029		
R ² Between	0.0595		
R ² Overall	0.0016		
F STATISTICS	11.07		0.0000
HETTEST: Chi2	194.15		0.0000
MEAN VIF	1.01		
HAUSMAN TEST: Chi2	34.05		0.0000

Source: STATA 13 Output, 2021 (Appendix II)

As shown in Table 4, the model findings demonstrate the existence of heteroscedasticity as made known by the Chi2 test Breuch Pagan/Cook-Weisberg of 194.15 and p-value 0.0000. Therefore, the null hypothesis that stated the residuals constantly variable, rejected. The p-value is statistically significant with a significance level of 1 percent. On the other hand, the table showed no multicollinearity exists amongst the explanatory variables as revealed by the mean inflation factor (VIF) of 1.01. The decision criteria for the inflation factor of variance are that a value of 10 or more indicates a perfect multi-linearity (Gujarati). The findings suggest that the fixed effect (inside) regression model is best suited for the research, as demonstrated in the Hausman specification test, Chi² of 34.05 for 1% significance with a p-value of 0.0000.

The finding from Table 4 thus shows that, in Nigeria's sample chosen list companies, about 10.29 percent of the total variations of the dependent variable (return on equity) based on a coefficient of various determinations of the R² of 0.4356. The table indicates fitted model, F-statistic of 11.07, which remains significant at the 1% meaning of the P-values of 0.0000. We also extend R2 of Sana'a et al., 2016; Affes et al., 2016; Manuel et al., 2014; Sanna, 2011; Wang et al., 2017). Therefore, accounting conservatism to profitability gives a better explanation of eliminating information asymmetric to be in line with agency theory in the Nigerian context.

4.4 Hypotheses testing

Table 4 shows that asymmetric timeliness (AT) to conservative accounting positively influences equity returns of the selected listed companies in Nigeria. The coefficient of 5,7862 and a t-value of 1,84 remains significant statistically at the significance level of 10 percent, a P-value of 0,067. There is thus a positive and substantive connection based on research. The study fails to reject the first null hypothesis (Ho₁), which stated conservatism (asymmetry and timeliness) does not substantially contribute to prolonging the profitability of sampled quoted corporations in Nigeria. Therefore, the research reveals that the agency theory proxy has considerably impacted profitability throughout the reviewed period as an asymmetry of the conservatism practice of chosen listed firms in Nigeria.

Similarly, Table 4 shows that the Basu adjusted default (DAB), with a conservative residual value of 25,547. The T-value of 4,64 has a positive effect on the profitability through a return to the stock of the selected sampled of the listed companies in Nigeria that are statistically significant by the 1% P-value level of 0.000. This finding means that for every 1% rise in the standard-adjusted Basu accounting

conservatism proxy as net earnings before interest divided by fair market value (debts + equity). Profitability is sustaining and prolonging by about 25%. This output provided us with the foundation to feel firm that the connection between accounting conservatism (DAB) and profitability is substantial and favourable. Thus, the study opposed the second null hypothesis (H_{02}), which states no significant connection between DAB and profitability. This result expands the results (Teymouri & Sadeghi, 2020; Aminu et al., 2017; Ayorinde et al., 2016). (Al-Nimer, & Dabaghia, 2017b) (Chen et al., 2014; Lara et al., 2009; Julish, 2013; Watts et al., 2006; Kim & Pevzner, 2010; Kim et al., 2010; Louis et al., 2014; Sultana & Zahn, 2015). The idea of agency also eliminated asymmetrically (Al-Sakini & Al-Awawdeh, 2015; Garcia et al., 2009; Hassani & Rahmani, 2014; Yero, 2013; Liu, 2010). Finally, the results show that Nigerian-listed firms in nature are more conservative in the countryside. Thus, our strong dedication to conservatism may lead to greater and sustainable profitability for local, national, and worldwide investors to invest directly.

5. Conclusion and recommendations

This research investigated the impact of asymmetry in timeliness proxies. Basu (DAB) adjusted default as independent factors and corporate size and leveraged them as the control variables on the profitability measure by return on equity of chosen listed companies of Nigeria. The research showed that conservative accounting policies had a beneficial impression on the cost-effectiveness of listed companies in Nigeria. Therefore, the recommended conventional accounting practice should be encouraged by the regulators, managers, and all other parties involved in reducing the declared revenue of companies. In contrast, cash flows continued due to unrecognized good earnings and exceeded the dividend selected by natural companies in Nigeria. This study proves that accounting conservatism can reduce information asymmetry. Translate accounting conservatism has a crucial role in presenting the true nature of the profitability of an entity. Based on the agency theory (win to win) among staff, managers, stakeholders, and interested parties. (Al-hroot et al., 2017; Shehu et al., 2017; Affes et al., 2016; Olyhoek & Carstens, 2017; Rebecca et al., 2016; Biyani, 2017; Sultana, 2015). However, the study does not investigate whether the hidden reserve of conservatism links to agency theory, which is one of the limitations suggested on behalf of further research.

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