



THE FINANCIAL IMPLICATIONS OF ACCOUNTING CONSERVATISM IN INDUSTRIAL SECTOR COMPANIES

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Abstract: The study examined the effect of accounting conservatism on reported performance of firms listed in the industrial sector. The study adopted the ex-post facto research design, which allows data existing in records of the company to be extracted. The data used was obtained from annual reports and accounts of selected and listed industrial sector companies. The population of this study comprised of all firms in the industrial sector listed in the Nigerian Exchange Group. For the period 2010 to 2023. A sample of 10 listed industrial sector companies were used. The data gathered was analyzed using ordinary least square regression technique via E-views version 9. The findings revealed that operating accrual and nonoperating accrual have a negative and insignificant effect on return on assets of listed firms in the industrial sector in Nigeria. It was recommended that the management of firms in the industrial sector must find a way to implement the accounting conservatism policy without prejudice to or decline in the profits and returns or harm to the rights of shareholders.

Keywords: Accounting Conservatism, Reported Performance, Industrial Sector

Introduction

The most important source of superficially reasonable information on companies is the financial statement. In spite of the prevalent use and continuing improvement in financial statement, users are concerned that accounting practice(s) has failed to keep pace with swift economic and technological vagaries which habitually affect the worth significance of accounting information. Basu (2017) pointed out that the international accounting standard board framework for the preparation and presentation of financial statement notes that information is appropriate when it stimulates the economic verdicts. Accounting information must be accomplished of making a difference in a decision by assisting consumers to forecast the outcomes of past, present, and future dealings. Accounting conservatism has been one of the palpable features of financial recording which have been united by theory and practice of accounting for stretched time. According to Chen, Chen and Su (2021) conservatism has been measured as an unsettled and prevailing piece in accounting and financial recording (statements). The prominence of conservatism is that managers have substantial choice in gauging firms' financial proceedings, as tolerable

within accounting guidelines. The notion of conservatism is that profit should not be expected, but should expect the acknowledgement of all losses (Watts, 2013). Therefore, conservatism can deliver worth relevant information that has not yet been apprehended in bottom line numbers (Basu, 2017). Accounting information principally renders services to groups and individuals who prefer to use qualitative and measurable information to acquire their investment goals. Making ideal decisions about investing in any business entity entails plain and comparable financial information. Consequently, preparing the information valuable in making investment decisions is one of the ultimate rudiments of making the investors interested in conducting economic processes. Financial reports are known as the major important source of financial information of firms. Financial performance is the measure of how well a firm can use its assets from its primary business to generate revenues. Ahmed and Duelluman (2021) noted that financial performance measures like profitability and liquidity among others provide a valuable tool to stake holders which aids in evaluating the past financial performance and current position of a firm. Financial performance evaluation are designed to provide answers to a broad range of important questions, some of which include whether the company has enough cash to meet all its obligations, is it generating sufficient volume of sales to justify recent investment. Accounting conservatism is closely linked with financial performance (Geimechi & Khodabakhshi 2015). Financial performance can be measured by variables which involve productivity, profitability, growth or, even, customers satisfaction. So the effect of the accounting Conservatism on the financial performance indicators and its effect on the profits, Return on Assets and other financial performance indicators become an essential requirement in preparing the financial reports of companies. This study contributes in enhancing the subject literature by clarifying the effect of the accounting conservatism on the financial performance in the Industrial sector of the Nigeria Exchange Group. In addition, accounting conservatism is one of the most important accounting constraints that have a big effect on preparing the financial reports (Basu, 2017). The industrial sector of a country is one of the leading drivers of its economic development. From Across the globe, economic capitals are shaped and defined by the power of its industrial output. Ahmed and Duelluman (2021) argued that almost all other sectors of the economy in one way or another depend on the products and services of the industrial sector in order to carry out their operations. Also, Guay and Verrecchia, (2016), noted that the financial performance of the firms in the industrial sector will serve as the bases for success or failure of the sector. Since conservatism has to do with what is reported, it is a worthwhile activity to establish an empirical evidence of the effect of accounting conservatism on reported financial performance of listed firms in the industrial sector.

Aim and Objectives of the Study

The general objective of the research is to determine the effect of accounting conservatism on reported performance of firms listed in the industrial sector. Specifically, the research seeks to determine:

1. The effect of operating accruals on return on asset (ROA) of listed industrial companies in Nigeria.
2. The effect of non-operating accruals on return on assets (ROA) of listed industrial companies in Nigeria.

Research Questions

The following research questions were raised to guide the study:

- i. To what extent does operating accruals have effect on return on asset (ROA) of listed industrial companies in Nigeria?
- ii. To what extent does non-operating accruals have effect on return on asset (ROA) of listed industrial companies in Nigeria?

Hypotheses

The following null hypotheses were formulated and will be tested at 0.05 level of significance.

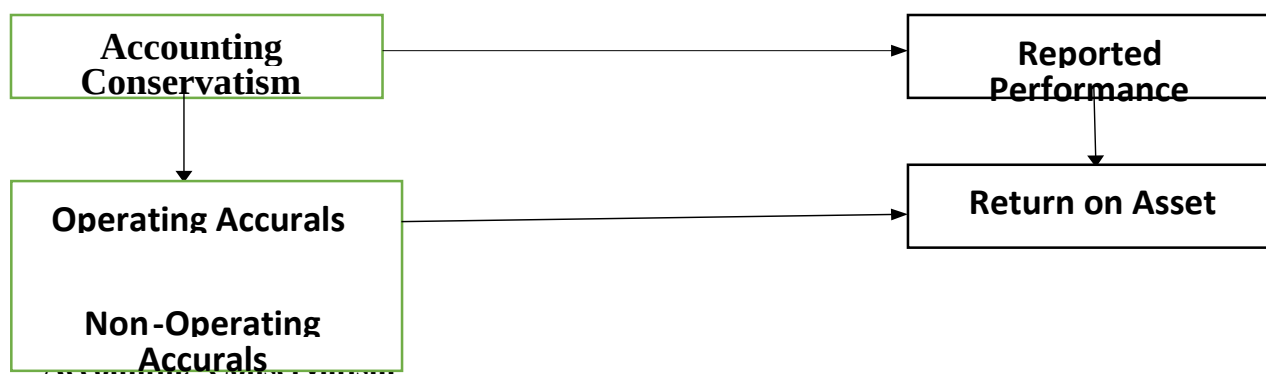
H₀₁: Operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

H₀₂: Non-operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

Literature Review

Uncertainty condition which would finally lead to lower assets and revenues and has the least positive influence on the owners' equity. Gim and Zhank (2020) notes that conservatism includes isolating the whole impending losses and non-recognition of the promising earnings. Basu (2017) defines conservatism as a procedure whereby

Conceptual Framework



Givoly And Hayn (2010) defined Conservatism as selecting an accounting approach under advanced degree of dependability is applied in recognizing and recording the earnings and hopeful news (incremental value); while lower degree of dependability is used in recognizing losses and detrimental news. Accounting conservatism can be defined as accounting policies or tendencies that contribute to a downward.

Operating Accruals and Non-Operating Accruals

Bergstresser and Philippon (2016) define accruals as components of earnings not depicted in current cash flows and their construction involves a great deal of managerial discretion. The model uses the level of earnings management as a proxy for earnings quality. Dechow, Ge and Schrand, (2020) distinguish “abnormal” from “normal” accruals by directly modeling the accrual process. The normal (non-discretionary) accruals are meant to capture adjustments that reflect fundamental performance, while the abnormal (discretionary) accruals are meant to capture distortions induced by application of the accounting rules or earnings management (i.e., due to an imperfect measurement system).

Reported Performance

A firm's financial performance is of importance to investors, stakeholders and the economy at large. Investors are interested in the returns for their investment. A business that is performing well can bring better reward to their investors. Financial performance of a firm can increase the income of its staff, rendering quality product or services to its customers and creating more goodwill in the environment it operates. A company that has good performance can generate more returns which can lead to future opportunities that can in turn create employment and increase the wealth of people. Firm's performance is the ability of a firm to achieve its objectives resources.

Return on Asset (ROA)

Pandey (2011) use ROA to measure corporate performance of firms listed on Tehran Stock Exchange. They defined ROA as investment return in assets, which represents the amount of profit that can be made use of corporate assets.

Theoretical Review

Conservatism Theory: Conservatism theory was propounded by Edmund Burke (1730-97) in 1760. Conservatism arises because of the tendency of the management to report net assets at the lowest value. Current conservatism is more associated with caution. Conservatism is a careful reaction to the inherent uncertainty in the company to try to ensure that uncertainty and inherent risks in the business environment are sufficiently considered. Risk uncertainty must be reflected in financial statements so that predictive and neutral values can be corrected. Basu(2017) carefully reported the benefits to all users of financial statements when conservatism was practiced. If the company chooses one of the two existing accounting techniques, then an alternative that is less profitable for shareholder equity must be chosen. The technique chosen is a technique that produces low asset and income values or that produces high debt value and costs.

Empirical Review

Sunday, Asuoquo and Enya (2020) examined the extent to which accruals discretionary created by management will affect growing concerns of listed manufacturing firms in Nigeria. The ex-post facto research design was adopted and data was gathered using method, panel regression model was employed combining the properties of time series and cross-sectional data. The study from the empirical data establishes that the operating accruals has negative and positive significant effect on liquidity and profitability of the studied companies. Nugroh and Jasman (2018) examined the impact of accruals quality on investment opportunity of firms listed in Indonesia. Ex-post facto research design was adopted, the study period of 2013-2016 was used. The sample of the study consist of firms listed on the Indonesia Manufacturing Sector between the study periods. Generalized Method of Moments and purposive sampling technique was utilized. Findings revealed that operating and non-operating accruals positively affects firm value. Mehranbain et al., (2021) examined accounting disclosure, accounting quality and conditional/unconditional conservatism. His findings indicate that those firms which have higher disclosure quality, have higher profitability and liquidity as well. Those firms which had change in management or have been supervised by one of the four biggest accounting institutes, tend to have a higher disclosure quality. Higher disclosure quality leads to less profit management. Also, these firms show higher conventional conservatism and lower unconditional conservatism. His findings indicate that conditional conservatism has a negative relationship with unconditional conservatism, in a way that conditional conservatism tends to increase efficiency while unconditional conservatism may facilitate opportunistic behavior of managers. The study also provide some evidence about asymmetry disclosure of loss in firms with high financial leverage.

Methodology

The study adopted the ex-post facto research design, which allows data existing in records of the company to be extracted. The data in use have been obtained through secondary sources, I.e. extraction from annual reports and accounts of selected and listed pharmaceutical companies. The population of this study comprised of all firms in the industrial sector listed in the Nigerian Stock Group. These are the A. G Leventis Nigeria; Academy Press; Austin Laz & Company; Beta Glass Co; C & I Leasing; Cement Company of Northern Nigeria; Chellarams; Cutix; Dangote Cement; Global Spectrum Energy Services; Grief Nigeria; Interlinked Technologies; John Holt;

Julius Berger Nigeria; Larfage Nigeria; Newrest ASL Nigeria; Nigerian Aviation Handling Company; UAC of Nigeria; The Initiates; Tripple Gee & Co; Red Star Express and Trans-Nationwide Express for the period 2010 to 2023. In order to ensure data accuracy and reliability from the firms listed in the population of the study (3.3), the following criteria were employed to select the sample of the study.

1. Firms that have been listed in Nigeria Exchange Group (NXG) between 2010 to 2020.
2. Due to the specific objectives to be achieved, the firms should have the required data needed to measure the proxies in the study within the study period. After using these criteria, 10 firms met the conditions and hence they formed the sample of the study.

Model of Specification

The model is presented as follows:

Financial Performance = $\alpha + \beta_1 \text{accounting conservatism} + e$ ---Research Model
The model was expanded into 2 equations viz:

$$\text{ROA}_{it} = \alpha + \beta_1 \text{OAC}_{it} + \beta_2 \text{NAC}_{it} + e_{it} \quad (1)$$

Where: ROA = Return of Asset α = Regression Constant

OAC = Operating Accruals for firm i at time t . NAC = Non-Operating Accruals for firm i at time t .

e = Error term

β_1 = Coefficients of Regressors

i = firm t = time period

Dependent Variable Measurement

Return on Asset (ROA): The component of the Dependent Variable is Return on Asset ROA as computed from the company's financial statements. ROA has been employed as a proxy for measuring financial performance in several studies, Mohammad and Qamar (2011); Siddik, Kabiraj and Joghee (2017); Rouf (2015); Hasan et. al. (2014); Ramadan and Ramadan (2015). The ROA would be measured by dividing the net income after tax by the book value of total asset, as adopted from (Pouraghajan, 2012). Hence:

$$\text{ROA} = \text{Net Income} / \text{Total Assets}$$

Independent Variable Measurement

Total Accruals

In the modified model, non-operating accruals are estimated during the event year (i.e., the year in which earnings management is hypothesized) as:

$$\text{NDA}_t = 1(1/\text{At} - 1) + 2[(\text{REV}_t - \text{RECT}) / \text{At} - 1] + 3(\text{PPE}_t / \text{At} - 1) \text{ where:}$$

RECT is net receivables in year t less net receivables in year $t - 1$, and the other variables are as in equation (3). It is important to note that the estimates of 1, 2, and 3 are those obtained from the original Jones Model, not from the modified model. The only adjustment relative to the original Jones Model is that the change in revenues is adjusted for the change in receivables in the event year (i.e., in the year earnings management is hypothesized).

The ordinary least square method via E-VIEWS statistics was used to analyse the data. The study used the adjusted coefficient of determination (adj. R²) as the unit to measure the effect of accounting conservatism on reported performance of firms listed in the industrial sector from 2010-2023. The decision is that the null hypothesis will be rejected if $p\text{-value} < 0.05$, otherwise it will be accepted.

Result and Analysis**Descriptive Statistics**

Analysis of descriptive statistics is carried out in this section so as to unveil the nature of data being used for analysis.

Table 1: Descriptive Statistics of Data

	ROA	OAC	NAC
Mean	-0.866364	8.46818 2	8.35454 5
Median	-1.050000	8.68000 0	8.68000 0
Maximum	0.560000	9.24000 0	9.20000 0
Minimum	-2.000000	6.78000 0	5.95000 0
Std. Dev.	0.826260	0.64418 7	0.88129 9
Skewness	0.287257	-1.648432	-1.989097
Kurtosis	1.902322	5.46704 5	6.24055 5
JarqueBera	0.703525	7.77133 0	12.0666 4
Probability	0.703447	0.02053 4	0.00239 8
Sum	-9.530000	93.1500 0	91.9000 0
Sum Sq. Dev.	6.827055	4.14976 4	7.76687 3

Table 4.1 present the descriptive statistics for the period 2010 to 2023. As revealed from the table, it showed that the mean of the log values of return on asset (ROA) of listed industrial firms in Nigeria was -0.866364 while the median was -1.05000. There was a positive skewness (0.287257) of ROA indicating that the degree of departure

from the mean of the distribution is positive revealing that there was a consistent increase in ROA from 2010 to 2020. The Kurtosis value was 1.902322 which is less than 3. This indicated that the degree of peakedness within the period of this study were normally distributed as most of the values hovered around the mean. The Jarque-Bera statistic is an indication of the normality of distributions was 0.703525. From the table also, the average of OAC is 8.468182 while the median was 8.680000. The maximum OAC were 9.240000 while the least was 6.780000. The standard deviation was 0.644187. As revealed by the skewness, there was a negative skewness (-1.648432) of operating accruals indicating that the degree of departure from the mean of the distribution is negative. This indicate that on the overall there was a consistent decrease in OAC from 2010 to 2020. As indicated by the Kurtosis which was 5.467045 > 3 which is the normal value indicates that the degree of peakedness within the period of this study was not normally distributed as most of the values did not hover around the mean. The Jarque-Bera statistic is an indication of the normality of distributions was 7.771330 and since the probability was 0.020534, the distribution was not normally distributed. From the table above, the average value of the log of non-operating accruals (NAC) measure is 8.354545 while the median was 8.680000. The maximum NAC is 9.200000 while the least was 5.950000. The standard deviation was 0.881299. There was a negative skewness (-1.989097) of indicating that the degree of departure from the mean of the distribution is negative. This indicated that on the overall there was a consistent decrease in NAC from 2010 to 2020. As indicated by the Kurtosis which was 6.240555 > 3, implies that the degree of peakedness within the period of this study was not normally distributed as most of the values did not hover around the mean. The Jarque-Bera statistic is an indication of the normality of distributions was 12.06664. **Correlational Analysis**

Table 4.2: Correlational Matrix of the Variables

	ROA	OAC	NAC	CCO	UCO	EXL	SIZE
ROA	1						
OAC	0.5753	1					
NAC	-0.3529	0.4729	1				
CCO	0.3303	-0.2894	-0.14327	1			
UCO	0.3127	-0.0211	0.20359	-0.12875	1		
EXL	0.4021	-0.0040	-0.06251	-0.0750	0.78700	1	
SIZE	-0.8002	0.4969	0.07930	-0.34980	-0.6919	-0.5648	1

Source: E-Views output (2022)

Table 4.2 shows the correlational matrix of the variables. The correlation matrix table shows that ROA has positive correlation with OAC. This means that the variables ROA and OAC, move in the same direction. However, a negative relationship is recorded between ROA and NAC. This means that the variables ROA and NAC and ROA and SIZE move in different direction.

Testing Hypotheses

Hypothesis 1

H₀₁: Operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

Table 4.3: Regression Analysis on ROA and OAC

Dependent Variable: ROA

Method: Panel Least Squares
 Date: 01/08/24 Time: 07:12
 Sample: 2010 2023
 Periods included: 11
 Cross-sections included: 10
 Total panel (balanced) observations: 110

Variable	Coefficient	Std. Error	t-Statistic	Prob.			
			2.866020	0.0099			
C	3.067702	1.070370					
	-						
OAC	0.196876	0.177304	-1.110388	0.2807			
	-						
SIZE	0.199158	0.198838	-1.001609	0.3291			
R-squared	0.285117	Mean dependent var	0.243636	Adjusted R-squared	0.209866	S.D. dependent var	1.410355
S.E. of regression	1.253657	Akaike info criterion	3.416130				
Sum squared resid	29.86145	Schwarz criterion	3.564909	Hannan-Quinn			
Log likelihood	34.57743	criter.	3.451178				
F-statistic	3.788892	Durbin-Watson stat	0.540737				
Prob(F-statistic)	0.041232						

Source: E -Views Output (2024)

As revealed from table 4.3 above, the variable of interest operating accruals has a negative coefficient of -0.196876 which implies that every unit increase of OAC will lead to a corresponding decrease of ROA by 0.196 units. Also, size has a negative coefficient of 0.199158 and a p-value is 0.3291 ($p > 0.05$), which implies that it is not significant. Generally, the coefficient of determination as revealed by R-square (R^2) was 28.5%. This indicates that 28.5% of variations observed in the dependent variable, Return on Asset (ROA) were explained by variations in the independent variable operating accruals and the control variables (size). The F-statistic is 3.789 and Prob(F-statistic) is 0.041232. Since the Prob(F-statistic) value is less than the 0.05, then the model has a good fit and can explain the return on asset fluctuations. The t-statistic value of OAC is -1.110388 and p-value is 0.2807. Since, the p-value is greater than 0.05 ($0.2807 > 0.05$), then the null hypothesis is retained. Hence, operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

Hypothesis 2

H₀₂: Non-operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

Table 4.4 Regression Analysis on ROA and NAC

Dependent Variable: ROA
 Method: Panel Least Squares

Date: 01/08/24 Time: 08:06

Sample: 2010 2023

Periods included: 11

Cross-sections included: 10

Total panel (balanced) observations: 110

Variable	Coefficient	t	Std. Error	t-Statistic	Prob.
C					
	2.4083		1.153575	2.087767	0.0505
NAC	0.117587		0.159483	0.737305	0.4699
SIZ	-0.429893		0.175760	-2.445911	0.0244
R-squared	0.259902	Mean dependent var	0.243636		
Adjusted R-squared	0.181997	S.D. dependent var	1.410355		
S.E. of regression	1.275575	Akaike info criterion	3.450794		
Sum squared resid	30.91472	Schwarz criterion	3.599573	Hannan-Quinn	
Log likelihood	-34.95874	criter.	3.485842		
F-statistic	3.336135	Durbin-Watson stat	0.596952		
Prob (F-statistic)	0.057312				

As revealed from table 4.4 above, the variable of interest non-operating accruals has a positive coefficient of 0.117587 which implies that every unit increase of NAC will lead to a corresponding increase of ROA by 0.117 units. Also, size has a negative coefficient of 0.429893 and a p-value is 0.4699 ($p > 0.05$), which implies that it is not significant. Generally, the coefficient of determination as revealed by R-square (R^2) was 25.9%. This indicates that 25.9% of variations observed in the dependent variable, Return on Asset (ROA) were explained by variations in the independent variable operating accruals and the control variables (size). The F-statistic is 3.336135 and Prob(F-statistic) is 0.057312. Since the Prob. (F-statistic) value is less than the 0.05, then the model has a good fit and can explain the return on asset fluctuations. The t-statistic value of NAC is 0.737305 and p-value is 0.466. Since, the p-value is greater than 0.05 ($0.2807 > 0.05$), then the null hypothesis is retained. Hence, non-operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria.

Discussion of Findings

The results from research question 1 revealed that the Operating accruals has a positive effect on return on assets (ROA). Also, results from hypothesis 1 revealed that operating accruals has a significant effect on return on asset (ROA) of listed companies in the industrial sector in Nigeria. This implies that operating accruals of firms listed in the industrial sector from 2010 to 2023 have a positive, but insignificant effect on the reported return on assets. This finding is in line with Nugroho and Jasman (2018), Sunday, Asuquo and Enya (2020) who reported that operating accruals has a positive and significant effect on reported performance. The results from research question 2 revealed that the non-operating accruals negatively impacts on return on assets (ROA). Also, results from hypothesis 2 revealed that non-operating accruals has no significant effect on return on asset (ROA) of listed industrial companies in Nigeria. This implies that non-operating accruals of firms listed in the industrial sector

from 2010 to 2023 have a negative impact, but insignificant effect on the reported return on assets. This finding is in line with Mehrabani et al. (2021) who studied the relationship between conservatism and unexpected accruals in TSE. Since the breakdown of accruals to unexpected accruals and expected accruals can affect the results of study, they used two models of adjusted Jones and adjusted Jones with non-linear flows. Their findings show that unexpected accruals resulted from adjusted Jones model have positive and significant relationship with conservatism. On the other hand, they did not find any positive and significant relationship between the effects of unexpected accruals resulted from adjusted Jones model and non-linear flows on conservatism.

Conclusion

The study has established that operating accrual and non-operating accrual have a negative and insignificant effect on return on assets of listed firms in the industrial sector in Nigeria.

Recommendations

The following recommendations are made based on the findings of the research dissertation:

- 1) The management of firms in the industrial sector must find a way to implement the accounting conservatism policy without prejudice to or decline in the profits and returns or harm to the rights of shareholders.
- 2) Stakeholders of industrial sector firms should seek the assistance of economic experts who can provide advice and solutions to increase their profit rate.

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