



International Conference on Accounting Studies 2014, ICAS 2014, 18-19 August 2014, Kuala Lumpur, Malaysia

Impact of regulatory framework and environmental factors on accounting practices by firms in Nigeria

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Abstract

This paper looked at development of accounting practice in Nigeria and analyzes how the country's economic, taxation, and other factors affect the development of financial accounting regulations in Nigeria. The study observed that political issues, privatization and capital market growth brought about several reforms that have improved financial reporting and disclosure requirements in Nigeria. The study suggests the strengthening the capacity of accounting regulatory bodies for monitoring and enforcing accounting standards, and building the capacity of accounting professional bodies to build the confidence of stakeholders in the accounting function and to inspire potential investors.

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Peer-review under responsibility of the School of Accountancy, College of Business, Universiti Utara Malaysia.

Keywords: Accounting development; accounting regulation; environmental factors; Nigerian firms;

1. Introduction

Over the years, commentators have been concerned about the need for accounting regulations. As a result, several countries responded to the call by many professionals for the enactment of regulations. Their efforts resulted in the passage of Sarbanes-Oxley Act by the U.S. Congress in July 2002, the European Union Act 1606/2002, the Corporate Law Economic Reform Program Act 2004 enacted by Australia in July, 2004 and the replacement of the Nigerian Accounting Standards Board Act 2003 with the Financial Reporting Council Act of

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2011. Regulating financial reporting involves not only setting of disclosure and practice requirements but also providing adequate mechanisms to monitor adherence and compliance with disclosure requirements. Baldwin and Cave (1999), argue that regulations are necessary so as to avoid windfall profits, to prevent profit-skimming and to avoid free rider effect. Regulations on financial reporting are very important especially now that the Nigerian Government is calling for foreign direct investment (FDI) in the private sector from international investors and Nigerians in diaspora to invest in the country. Investors and other financial statement users need information to enable them to decide where to invest. Adequate supply of such information made possible by will reduce adverse selection and moral hazard problems so that investors are protected.

Nigerian accounting practices have followed patterns of the British accounting system and the legal regulation of businesses in Nigeria took its roots from the British. In view of the fact that Nigeria was under British rule and influence, the country's company law has mirrored the company law of the United Kingdom (Okike, 1994). Furthermore, Nigerian system of personal income tax administration follows the British system which was introduced in 1904. Although the personal income tax Act of 1993 is currently in use, most of its provisions were borrowed from the British accounting system. Thus, Nigerian accounting system is similar to other African countries that are within the African Anglo-Saxon bloc, different from Franco-German African countries whose accounting practices are influenced by the ideals of their colonizers.

Consequently, it is worthwhile to examine the institutional framework and environmental factors that affect accounting regulations and compare them with the existing enforcement mechanisms in order to have a better understanding of financial accounting regulations. This study, therefore, is aimed at providing information about the structure and development of Nigeria's improved financial reporting regulations and disclosure practices, which will assist in boosting international investor's confidence and hence attract more FDI to the country.

2. Nigeria: A brief profile

Nigeria is Africa's most populous nation with an estimated population of over 168 million people with an average annual growth rate of 3.04% in 2012 See Fig. 1. Nigeria attained independence on October 1, 1960 from Britain and became a republic in 1963 It shared borders with Republic of Benin in the west, Chad and Cameroun in the east, Republic of Niger in the north and borders in south bordering a vast coastline of the Atlantic Ocean measuring about 800 kilometers in the Gulf of Guinea (Nwakpa, 2008).

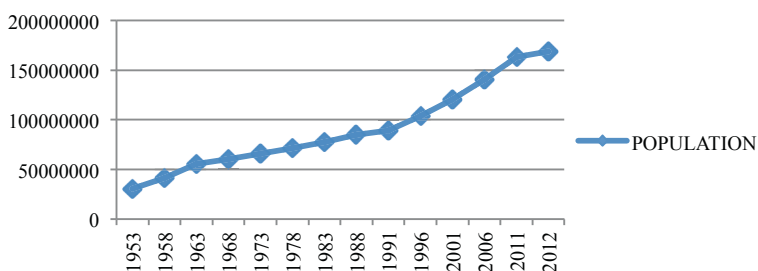


Fig. 1: Population Trend In Nigeria
Source: Nigerian Population Commission

Nigeria is endowed with abundant natural resource such as timber, gold, coal, limestone, iron and ore (Starlink, 2013). It has about 37.2 billion barrels of proven oil reserve, produces about 2.3 million barrels of crude oil per day and has about 187 trillion cubic feet of proven natural gas (Starlink, 2013). The structure of the Nigerian economy is geared towards the production of two primary products: agricultural products and crude oil (CBN, 2012). Agriculture and the oil and gas sectors control the economic activities of Nigeria with the oil and gas sector accounting for about 15.0% of GDP, 79.0% of Federal Government Revenue and 71.0% of export revenue while agriculture sector accounts for 30.9% of GDP and employs about 70.0% of the labor force (Starlink, 2013).

Unemployment stands at a high rate of 25.7% in 2012 (CBN, 2012) because the sector driving the economy are not high job-creating sectors e.g. the oil and gas sector is a capital intensive “enclave” with very little employment-generating potential Fig. 2 present trends of unemployment in Nigeria and inflation remained above the single digit level closing at 12.2% by the end of December 2012 (NBS, 2012), Fig. 3 provide inflation trend of Nigeria. Its GDP was N40, 115.3 billion (USD254.7) with an annual growth rate of 6.6 percent in 2012 (CBN 2012) see Table 1 Nigeria being the world’s 8th largest oil producer and 6th oil exporter, has the world’s 6th largest deposit of natural gas (ROSC, 2011) and has the largest market for goods and services in Africa.

Table 1: Gross Domestic Product (GDP) at Currencies (₦billions)

| Year | GDP | Growth % |
|------|----------|----------|
| 2002 | 7984.4 | 4.6 |
| 2003 | 10,136.4 | 9.6 |
| 2004 | 11673.6 | 6.6 |
| 2005 | 14,894.5 | 6.5 |
| 2006 | 18,222.8 | 5.6 |
| 2007 | 20,853.6 | 6.5 |
| 2008 | 24,084.5 | 6.4 |
| 2009 | 25,236.1 | 7.0 |
| 2010 | 34,494.6 | 8.0 |
| 2011 | 38,017.0 | 7.4 |
| 2012 | 40,115.3 | 6.6 |

Sources: CBN Annual Reports Various Editions

3. Development of accounting in Nigeria

The development of accounting profession could be traced to the period of struggle for political independence in Nigeria alongside the constitutional conference of 1957 held in London (Uche, 2003). Since then, accounting and auditing have been recognized as professions. Soon after the attainment of political independence by Nigeria, universities and polytechnics introduced courses in accounting (Isah, 2009). As a result of general acceptance of accounting, Nigerian experts from various parts of the world were invited into the country which later resulted to the establishment of an accounting association called Association of Nigerian Accountants (Wallace, 1992). In 1963, the association made first attempt at establishing a national indigenous accounting professional body in Nigeria (Odianson, 2011). The association was granted official charter in 1965 with the new name Institute of Chartered Accountants of Nigeria (ICAN) by an Act of Parliament No. 15 of 1965 (Uche, 2003). The Nigerian Accounting Teachers Association (NATA) now called The Nigerian Accounting Association was established with the main objective of promoting accounting education and research in Nigeria (Isah, 2009).

In 1981, the Association of National Accountants of Nigeria (ANAN), which had been working hard to be registered obtained recognition of the government. In August 1993 ANAN was granted Charter by Decree No. 76 of 1993 and became the second recognized body of accountants in Nigeria (Uche, 2003). Other accounting professional bodies and associations in Nigeria include: the Chartered Institute of Taxation of Nigeria (CITN) chartered by Act No.76 of 1992 (CITN Act, 1992), the Institute of Certified Public Accountants of Nigeria established in May 1998 and the Chartered Institute of Cost and Management Accountants of Nigeria established in the year 2000. All these attest to the extent to which accounting is becoming a popular field of study in Nigeria.

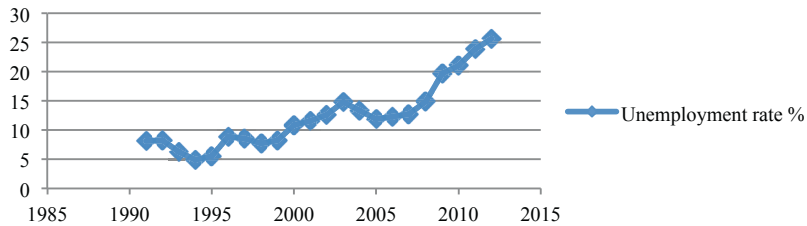


Fig. 2: Unemployment rate % in Nigeria
Source: CBN Annual Reports Various Editions and NBS Annual Abstract of Statistics

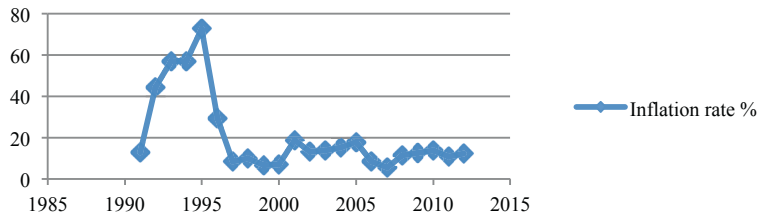


Fig. 3: Inflation rate % in Nigeria
Sources: CBN Annual Reports Various Edition and Idris and Abubakar (2008)

4. Accounting regulatory framework in Nigeria

Regulation of accounting information is aimed at ensuring that users of financial statements receive a minimum amount of information that will enable them make meaningful economic decisions regarding their interests. The institutions responsible for these regulations are often statutory agencies such as: Central Bank of Nigeria, Nigerian Accounting Standards Board now Financial Reporting Council, National Insurance Commission, Securities and Exchange Commission, Institute of Chartered Accountants of Nigeria, Nigerian Stock Exchange, Association of National Accountants of Nigeria, Nigerian Deposit Insurance Corporation, Federal Ministry of Finance and Federal Ministry of Commerce, Industry and Tourism.

4.1 *The Companies and Allied Matters Act, (CAMA, 1990)*

As indicated earlier, the legal environment of business in Nigeria had its roots from the United Kingdom (UK). The first Companies Act came in 1968. Section 142, Schedule 8 of the Companies Act addressed the issue of company accounts. In 1987, the Nigerian Military Government deemed it necessary to review the 1968 Companies Act and thus set up a consultative committee on the issue. Until the advent of CAMA 1990, the Companies Act regulated the activities of all private and public companies incorporated in Nigeria (Okike, 1994). The Companies and Allied Matters Decree (No. 10) of 1990 was signed into law. Section 358(1) of the Act dealt with the qualification of auditors, section 358(C) exempt audit firms offering consultancy services from being appointed auditors for the same company (Uche, 2002). Presently CAMA 1990 prescribes disclosure requirements of standards, format and content of company financial statements.

4.2 *Banks and other Financial Institutions Act, (BOFIA, 1991)*

The legal auspices for the regulation of Banks and Other Non-Bank Financial institutions in Nigeria is the Banks and Other Financial Institutions Act, 1991 (ROSC, 2011). Supervision and regulation of banks in Nigeria is vested in the Central Bank of Nigeria (CBN). CBN Act (No. 24) 1991 was replaced with CBN Act 2007 and

BOFIA Act (No 25) 1991 designates the CBN as the main regulator of the banking industry. The Nigerian Deposit Insurance Corporation (NDIC) complements the efforts of CBN in bank supervision. The deposit insurance system was established in Nigeria in 1988 as a fallout of economic deregulation (Odiannson, 2011). The Central Bank of Nigeria prescribes minimum instructive disclosure requirements pertinent to banks financial statements and the appointment of statutory auditors. Information disclosed by banks are guided by different laws and regulations such as CAMA Act (No1) of 1990, NDIC Act (No. 22) of 1988, BOFIA Act (No. 25) of 1991 and S 43 of CBN Act, 2007 support the existence of a financial service regulation committee to coordinate the supervision of financial institutions (ROSC, 2011).

4.3. Insurance Act of 2003

The regulatory agency for the insurance industry in Nigeria is the National Insurance Commission (NAICOM). While the legal statute is the Insurance Act, 2003. CAMA, 1990 and Insurance Act, 2003 established financial reporting disclosure requirements for insurance companies (ROSC, 2011). NAICOM performs both off-site and on-site review of compliance with accounting and auditing requirements in the course of carrying out supervisory activities (ROSC, 2011).

4.4. Capital market regulatory agencies

The Securities and Exchange Commission (SEC) and The Nigerian Stock Exchange (NSE) specify and regulate financial reporting and disclosure requirements of listed companies in Nigeria (Odiannson, 2011). SEC came into operation following the enactment of SEC Act of 1979 later re-enacted as Act 29, of 1998 (ROSC, 2011). The activities of SEC were facilitated by the Investment and Securities Act (ISA) 1999 which was repealed by the ISA Act 2007. Section 63 of ISA 2007 mandated an auditor to issue a statement in an audit report in relation to the existence, efficiency or weaknesses of the internal control mechanism of a public company (ROSC, 2011). SEC was given legal rights by ISA 1999 and ISA 2007 AND SEC rules and regulations of 1999 to regulate securities and investment businesses.

4.5. The accounting profession

Two self-regulatory professional accountancy bodies exist in Nigeria. The Institute of Chartered Accountants of Nigeria (ICAN) established by Act of Parliament (No. 15) 1965. ICAN acts as both an examining body for awarding chartered accountant certificates and the licensing authority for members engaged in public auditing practices. The Association of National Accountants of Nigeria (ANAN) was chartered by Decree No 76 of 1993. The Decree establishing ANAN was signed into law on August 25th, 1993. The decree brought about a paradigm shift in the accounting profession as it provided a podium for another accountancy body. Though both bodies were established at different times, they are nonetheless empowered with similar responsibilities which include the general duty of advancing and regulating the accounting profession and determining what standards of knowledge and skills are to be obtained by persons seeking to become members of the accountancy profession in Nigeria.

4.6. The role of Corporate Affairs Commission (CAC) as per CAMA, 1990 requirements

According to Inyang (2009), CAC emerged as an independent institution to replace the Companies Registry, a segment of the Federal Ministry of Commerce and Tourism which controlled the registration and administration of companies. Section 1 of CAMA 1990 formed CAC and mandated it with the responsibility of overseeing the formation, registration, incorporation and winding up of companies. All registered companies are mandated to submit audited financial statements to CAC within a period of 42 days of annual general meeting.

5. Environmental factors affecting accounting development in Nigeria

5.1. Political influence

Assenso-Okofu et al. (2011) observed that political systems affect financial reporting and disclosure practices of a country. Nigeria has experienced various political and military unrests due to coup d'états, counter-coups and a civil war that adversely affected its political stability. Since independence in 1960, Nigeria had 13 different governments; eight of them military eras and five civilian administrations. It can be attested that turbulent political systems after independence has failed to improve accounting information disclosure. However, the steady democratic political system put in place since 1999 has indicated some improvement in the country's accounting environment epitomized by the enactment of the Nigerian Accounting Standards Board Act, 2003 now replaced with Financial Reporting Council Act (No. 6) of 2011 which mandated the adoption of IFRS, a repeal of ISA, 1991 with ISA 2007 in an effort to ensure effective regulation, protection of investment and maintenance of fair, efficient and transparent market. Again a repeal of CBN Act 1991 with CBN Act 2007 provides for the establishment of a Financial Service Regulation Coordinating Committee to coordinate the supervision of financial institutions.

5.2. Economic influence

Adhikari and Tondkar (1992) observed that a country's level of economic growth has a significant impact on the development of accounting systems and practices. At independence, the Nigerian economy was heavily reliant on the non-oil sector with agriculture contributing over 60 percent of GDP and 90 percent of exports. Manufacturing was less than 3 percent of GDP and 1 percent of export while the oil sector represented only 0.2 percent of GDP (UNCTAD, 2009). The oil boom of the 1970's brought with it fundamental changes in the Nigerian economy that led to the neglect of the non-oil sector of the economy resulting in the sectors declining contribution to GDP. By the 1980's, the oil sector accounted for 22 percent of GDP and provided 80 percent of government revenue and over 96 percent of export earnings (Anyanwu et al, 1997). Starting from mid-1981, the world oil market began to collapse due to a glut (Anyanwu et al, 1997) and with it an economic crisis ensued in Nigeria. The resultant fall in oil exports and prices were reflected in revenues which threw the country's public finance into disarray. This prompted the government to introduce reforms with the aim of boosting non-oil sector revenue with focus on agriculture, solid mineral, manufacturing, and tourism and hospitality industries.

5.3. Taxation

Tax laws affect accounting and disclosures as revenue and expenditure are recorded for tax purposes (Assenso-Okofu et al, 2011). The tax regime in Nigeria is governed by various legislations: the Companies Income Tax Act (CITA) of 1979 as amended by Finance (Miscellaneous Provision) Decree 1993 and again amended in 2007 and 2011. The Income Tax Management Act (ITMA) of 1961 repealed and replaced by the Personal Income Tax Act (No. 104) of 1993 and as amended in 2011, the Sales Tax Decree of 1986 replaced with Value Added Tax (VAT) Decree (No. 102) of 1993 and Petroleum Profit Tax Act (PPTA) of 1959 re-enacted as Chapter P13 of the Laws of the Federation of Nigeria (LFN) 2004. Nigerian tax rules are separate from commercial rules. Companies pay income tax on the profits shown in their annual financial reports. Nigeria does not use tax-reporting procedures for financial reporting. The tax on profits which is calculated on accrual basis is assessed according to certified financial statements. Sections 52-55 of CITA (as amended in 2007) requires every company registered in Nigeria on annual basis, whether liable to pay tax or not to file returns of its income together with its audited accounts with the Federal Inland Revenue Service.

5.4. The Nigerian capital market

The existence of a Capital Market is a major element which contributes to the growth of a country (Odiannson, 2011). Pardy (1992) indicated that the growth of the private sector relies heavily on capital market activities. Well-developed capital markets promote good accounting reporting and most likely lead to quality accounting reporting practices (Adhikari and Tondkar, 1992). The Nigerian Stock Exchange (NSE), which until 1977 was known as the Lagos Stock Exchange, came into being in 1960 but started operations with less than 10 stocks in 1961 (Sanda et al, 2005). Right now, NSE is computerized with automated clearing and settlement trading. It also has listing requirements for companies which are quoted on the NSE in line with international stock exchange practices. It releases sectoral performance indices report which enables investors to assess performance of listed companies. The Nigerian capital market has evidenced formidable growth in recent years, this growth being attributable to the Federal Government's reform programs in the areas of Banks and Insurance consolidation, privatization, pension reform, as well as increased investor awareness, and relative political stability (CBN, 2007).

Table 2: Indicators of Capital Market Development in NSE

| Year | Number of listed securities | Volume of Stocks Traded (Turnover Volume) Billion | Value of Stocks Traded (Turnover Value) N'Billion | Value of Stock as % of GDP | Total Mkt Cap N'Billion | Total Mkt Cap as % of GDP |
|------|-----------------------------|---|---|----------------------------|-------------------------|---------------------------|
| 2002 | 258 | 6.6 | 59.4 | 0.7 | 747.6 | 9.4 |
| 2003 | 265 | 13.3 | 120.4 | 1.2 | 1324.9 | 13.1 |
| 2004 | 277 | 19.2 | 225.8 | 1.9 | 1925.9 | 16.5 |
| 2005 | 288 | 26.7 | 262.9 | 1.8 | 2900.1 | 19.5 |
| 2006 | 288 | 36.5 | 470.3 | 2.6 | 5120.9 | 28.1 |
| 2007 | 310 | 138.1 | 2,100.0 | 9.2 | 13294.6 | 56.0 |
| 2008 | 301 | 193.1 | 2,400.0 | 10.0 | 9535.8 | 39.7 |
| 2009 | 266 | 102.9 | 685.7 | 10.0 | 7032.1 | 28.5 |
| 2010 | 264 | 93.3 | 797.6 | 0.3 | 9918.2 | 33.6 |
| 2011 | 250 | 90.7 | 638.9 | 1.7 | 10,275.3 | 27.5 |
| 2012 | 256 | 104.2 | 809.0 | 2.0 | 14,800.9 | 36.5 |

Source: CBN Annual Reports Various Editions

5.5. The Nigerian privatization policy

Jerome (2008), revealed that privatization of state-owned enterprises (SOEs) has become a key constituent of structural reform processes and globalization strategy in many countries. Privatization also helps attract foreign direct investment which leads to good accounting disclosure practices (Shehadi, 2002). Nigeria initiated its privatization programs in July 1986 in order to improve the efficiency and performance of SOEs. During that time one hundred and eleven (111) enterprises were slated for full or partial privatization while 35 others were to be commercialized (Jerome, 2004). The divestment took the form of private placement of equity, sale of assets, management buy-outs, deferred public offer and public offer of equity shares for sale. During the divestment it was estimated that the privatization program yielded gross revenue of about N28 billion (UNCTAD, 2009). Privatization compels governments to make changes in the legal framework and corporate governance mechanisms to ensure qualitative corporate disclosure practices (Al-Akra et al. 2009). Consequently, the Nigerian government implemented several reforms in order to ensure the smooth operation of the privatization program with the amendment of the Nigerian Enterprises Promotion Decree of 1977 into the Public Enterprises (Privatization and Commercialization) Act, 1999. This Act repealed the Privatization and Commercialization Decree (No. 25) of 1998, which had also repealed the Bureau for Public Enterprises Decree (No. 78) of 1993. The Public Enterprises (Privatization and Commercialization) Act of 1999 enacted a new framework under which the entire program was to be carried out.

6. Ensuring compliance with accounting regulations

Different approaches have been used to ensure enforcement capabilities with respect to financial reporting regulations (Nobes & Parker, 2010). First, government attitude towards financial reporting varies across countries and second, is the extent to which the private sector should participate in setting and enforcing financial reporting rules (Nobes & Parker, 2010). In Nigeria, the enforcement of financial accounting rules is largely vested in government agencies. However, recent regulatory changes have enabled certain private sector regulatory institutions to enforce compliance. The mechanisms for monitoring and ensuring compliance with financial reporting are provided by CAMA, 1990 and other Acts related to the powers and responsibilities of regulators. A report on the observance of standards and codes in Nigeria organized jointly by World Bank and IMF (ROSC, 2011) indicated that the Central Bank of Nigeria (CBN) has improved its monitoring and enforcement mechanisms of financial reporting. In this context, CBN monitors strict adherence to financial reporting requirements and other issues that affect capital adequacy of the regulated entities. Furthermore, the Nigerian Accounting Standards Board has improved upon its monitoring and regulatory functions. However, according ROSC (2011), compliance with financial reporting requirements of the CAC is weak. It is a legal requirement to file a copy of audited financial statements and auditor's report with the commission; there is however no rigorous enforcement of timely filing and no sanctions are applied. SEC and NSE are to monitor listed companies with respect to accounting and disclosure requirements but these agencies lack technical and human resources to review compliance with accounting standards as most officials lack adequate knowledge on practical aspects of applying IFRS. Furthermore, compliance with financial reporting requirements of insurance companies is weak; NAICOM capacity to monitor and enforce compliance is inadequate and the quality assurance review of professional practice of audit firms and individual auditors falls short of international best practices.

7. Conclusion

This paper fundamentally examined the origins and development of accounting in Nigeria, particularly examining how environmental factors have influenced the development of financial accounting regulation in Nigeria. The study has established that accounting has been practiced as early as the pre-independence era and that Nigeria's accounting system was based on British accounting policies. It further observed that accounting and reporting practices in Nigeria are directly influenced by regulatory and institutional framework and also indirectly affected by political factors especially during democratic dispensations. It was also found that privatization has greatly influenced Nigeria's accounting regulations by prompting the government to enact new disclosure regulations. Despite a number of positive measures taken by the government and regulatory bodies to improve accounting and the compliance regime, some Nigerian institutions are still weak in monitoring and enforcing compliance. Thus, this study recommends the strengthening of the capacity of accounting regulatory bodies for issuing, monitoring and enforcing accounting standards. Building the capacity of professional accounting bodies to function as modern professional organizations and to comply with IFAC statement by putting in place arrangements for high-quality practice review of practicing auditors is also recommended.

Acknowledgement

I am grateful to Dr. Salihu D.D, Dr. Nasiru Otega, Dr. Idris A, Dr. Danyaya M., Mr. Yeboah K.B. and Mrs. Nnowodo E.C for their helpful comments. I am also grateful to the anonymous reviewers for ICAS 2014 for their useful comments and suggestions. However, the author is responsible for errors and omissions.

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