

## ACCOUNTING THEORY: FORMULATION AND DIVERSITIES IN THE USE OF ACCOUNTING INFORMATION

<sup>1</sup>OLOWOOKERE JOHNSON KOLAWOLE, <sup>2</sup>ADENLE OLUWATIMILEYIN ESTHER,

<sup>3</sup>IJAIYA MUHAMMED OLAYEMI & <sup>4</sup>ANYANWU PROGRESS ONYEKACHI

<sup>1-2</sup>Department of Accounting, Osun State University, Osogbo, Osun State, Nigeria

<sup>3-4</sup> Department of Accountancy, Federal Polytechnic, Offa, Kwara State, Nigeria

<sup>1</sup>[johnson.olwokeere@uniosun.edu.ng](mailto:johnson.olwokeere@uniosun.edu.ng), <sup>3</sup>[ijaiyamuhammed2@gmail.com](mailto:ijaiyamuhammed2@gmail.com),

<sup>4</sup>[progressnnw@gmail.com](mailto:progressnnw@gmail.com)

Corresponding Author: <sup>2</sup>[oluwatimileyinadenle@uniosun.edu.ng](mailto:oluwatimileyinadenle@uniosun.edu.ng)

### ABSTRACT

*This paper assessed the approaches to the formulation of accounting theory, the reasons why there are different accounting theory and the areas of diversities in the use of accounting information. The study adopted expository research design by reviewing existing literatures. This study used secondary data obtained from the internet by reviewing 45 literatures that are related to accounting theory formulation and diversities in the use of accounting information. Results of this study after the extensive review of the concept of accounting theory formulation discovered that in accounting; practice comes before theory. The findings also discovered that the reason why there are different accounting theories is that each theory were formulated to meet the needs of different users of accounting information and also because of the absence of generally acceptable accounting theories. This study concluded that there is no universal accepted accounting theory and that accounting has several conflicting theories that has led to inconsistency in accounting practices. The study recommends that accounting bodies and standard setters should develop a universal accounting theory that will meet every users of accounting information needs. The theory should be developed in such a way that it will be difficult to influence, this will ensure globally acceptability of the theory.*

**Keywords:** Accounting Information, Accounting practices, Accounting theory, Practitioners.

### 1. Introduction

A theory is a product of scientific methodology. It begins by the observation of natural phenomenon, hypothesizing about the phenomenon, experimenting to prove or disapprove the hypothesis and reaching a conclusion (Kerlinger,1973). According to Adeleke, et al (2018), theory is regarded as the basis for clarification with respect to why certain occurrence happens the way they do. According to Hendriksen (1992), accounting theory refers to a logical reasoning approach that consists of a set of broad principles that provide a framework to evaluate accounting practices and guide the development of new processes. It encompasses a range of frameworks, assumptions, and methodologies that are employed in the study and application of financial reporting principles. Studying accounting theory encompasses examining the historical origins of accounting practices, along with how these practices are adapted and incorporated into the regulatory framework governing financial reporting. Abor and Biekpe, (2006) as cited in the study of Osho and Adindu, (2018) stated that accounting theory is useful for organizations and small scale businesses because it ensures that proper

accounting records and information records are being kept, and also ensure that organizations and small scale businesses comply with the standard accounting principles. Accounting theory provides for effective financial reporting. The Financial Accounting Standards Board (FASB) has established a conceptual framework of accounting that all accounting theories must adhere to.

Further, accounting theory is an important aspect of accounting that has been acknowledged by several accounting authors, particularly in the early stage of accounting thought development. This field emerge from the real world, involving both users and non-users of accounting information, and their value judgments generate theories for accounting policies and standards (Osho&Omotayo, 2018). Accounting information users includes; management, employees, financial analysts, investors, customers, suppliers, general public, government and the tax practitioners. As business operations and risks become more complex, accounting theories are continually being revised or modified to keep up with these changes. Although, there is no universally accepted theory of accounting.

The Financial Accounting Standards Board (FASB) governs the interpretation and usage of accounting theory in the United States, providing guidance for accounting practices. The primary aim of accounting theory is to offer a framework for forecasting and clarifying accounting activities and occurrences. Due to the various users and applications of accounting information, diverse accounting theories exist. Accounting information has various users and the diversities in the usage of accounting information has led to the reason why we have various accounting theories.

Several authors, including Adebayo et al. (2022), Osho&Ajayi (2018), Osho&Adindu (2018), Osho and Omotayo (2018), and Riahi-Belkaoui (2004), have focused on the importance of accounting theory, its utility, and its development. However, few have explored the reasons behind the existence of various accounting theories, their limitations, and the differences in how accounting information is utilized. To address this gap, this paper provides a concise overview of the methodologies used in developing accounting theory, its constraints, the variations in the use of accounting information, and the factors contributing to the diversity in accounting theories that previous researchers have overlooked. This research will be valuable to accountants, accounting organizations, researchers, policymakers, educators, practitioners, and standard setters. The objective of this study is to comprehensively examine the creation of accounting theory and the diversity in the application of accounting information.

## **2. Review of Related Literature**

### **History of Accounting Theory**

Accounting is commonly considered as the language of business, as it is used to communicate business activities through financial statements. Due to the incessant change in social and economic factors, accountants however are faced with new challenge of how to apply accounting principles to areas which traditional accounting principles does not applies, the fact that accountants are accountable to their clients and third parties make it more difficult to convinced specialist of other professions on how the traditional principles are being applied. In other to provide solutions to the challenge faced by accountants, accounting theory which comprises of principles and practices was introduced (Abubakar, et al 2011).

According to Bello (2022), the origins of accounting theory can be traced back 500 years ago, but significant advancements in its use did not occur until the late 1960s to 1980s. In recent history, there have been two major periods of upheaval in the development of accounting practice. The first occurred in the early 1930s and the second in the 1960s, during which there were pressures from both external groups and dissatisfied practitioners and academics (Hendriksen, 1982). The American Institute of Accountants responded to this pressures in 1930 by establishing its first standing committee to address accounting procedure issues and provide guidance to the profession. Similarly, in the United Kingdom around 1929, reforms were introduced requiring companies to prepare the maiden edition of profit and loss accounts (Hendriksen, 1982). These actions were indicative of a wish to increase accounting practice rather than theory, but they did stimulate discussions that ultimately contributed to the establishment of accounting theory.

Godfrey et al. (2006) noted that the period from 1956 to 1970 is considered the normative period during which the best practices of accounting were established. In 1960, accounting orientation began to focus on decision-making and usefulness, and the American Accounting Association issued the Statement of Basic Accounting Theory (ASOBAT) in the year 1966, which is seen as the initial point for this orientation (Hicks, 1966). This shift towards decision-usefulness meant that the focus moved from accounting principles to the procedures used to provide information (Reiter & Williams, 2002). The 1970 Congress of Accounting Historians held in Brussels had a significant impact on the field of accounting history (Zimmerman, 1979).

Zimmerman (1979) argues that accounting theory serves as a justification for government intervention and meets the need for justifications. There are many school of thought about accounting theories but the two most common accounting theories are the one which focuses on the expansion of new practices and processes and the second school of thought clarifies accounting theory as action that endeavor to evaluate accounting practices itself (Riahi-Belkaoui, 2004). The two accounting theory school of thought are grounded on two major approaches which are the normative and descriptive approach or methodologies. The normative approach, also referred to as a deductive approach and not considered scientific, challenges current theories, emphasizes results, and outlines what the theory ought to be. In contrast, the descriptive approach is an inductive method that explores the underlying phenomenon or concentrates on real-world observations.

Moreover, Bello (2022) revealed that there are some criteria that a good accounting theory must fulfil, the criteria are; the theories must be capable of being tested, it must be consistent, it must be able to predict the same outcome for every identical case, the theories must provide be able to explain an observed phenomenon, it must also provide framework for the establishment of new procedures and ideas. Also, it must be able to assist in making decision or choices among different alternatives.

### **Approaches to the Formulation of Accounting Theory**

There are multiple methodologies to developing accounting theory, which can be categorized as traditional or non-traditional. The traditional approaches lack a rigorous process of verification when creating an accounting theory, the traditional approaches can be divided into theoretical and non-theoretical approaches (Abubakar et al., 2011).

### **Non-Theoretical Approaches**

Non-theoretical approaches focus on developing accounting methods and principles that are useful for decision-makers, with the aim of benefiting manipulators. Abubakar et al. (2011) explain that this approach ensures that accounting principles and techniques are chosen based on their usefulness and relevance to decision-making. While this approach has been successful in the past, it has limitations in resolving conflicts between different accounting philosophies and practices. The non-theoretical approach can be established in a authoritarian or practical approach. The practical approach, also known as the pragmatic approach, aims to develop accounting theories with operational utility, which depends on understanding the relationship between business phenomena, measurement system constraints, and the needs of accounting information users. This approach is problem-solving oriented, although it only provides tentative solutions to problems. The practical approach involves developing ideals that align with real-world situations. The authoritarian approach entails discriminating between theories that are well founded but conflicting in nature (Bello, 2022). This approach also equates with practical approach because it's grounded based on operational utility but it is under the approval of regulatory bodies.

### **Theoretical/ Formal approaches to the Formulation of Accounting Theory**

There are several theoretical approaches to accounting theory, which include the deductive approach, inductive approach, ethical approach, sociological approach, economic approach, and eclectic approach. The deductive approach is centered around beginning with fundamental propositions, premises, and assumptions, and using them to establish accounting principles that ultimately result in practical and tangible solutions. According to Edwards and Bell (1961), the deductive approach in accounting theory is founded upon establishing objectives and goals. However, if the underlying assumptions and propositions are incorrect, the results conclusions may be flawed. The validity of this approach is determined by examining whether its outcomes are effective in practical application. The benefits of using the deductive approach includes; its emphasis on goals and objectives, the generation of general guidelines for action based on theory rather than experience, and its flexibility as a guide. Inductive approach in accounting theory involves beginning with observed phenomena and then drawing generalized conclusions from them. In order to support its conclusions, the inductive approach requires experimental testing (Zalaghi&Khazaei, 2016).

The moral perspective of social welfare is emphasized by Riahi-Belkaoui (2014), which urges businesses to consider the impact of their production activities on the environment by disclosing and measuring the financial statements. By doing so, businesses can take responsibility for their impact on society and demonstrate the social costs and benefits associated with their operations. This approach aims to account for the social effects of a business entity's actions according to Osho and Omotayo (2018). The Swedish national GAAP and the IASB consider this economic approach when developing their standards (Zancanaro 2021). Eclectic approach lead to the establishment of novel approaches to accounting theory. It has been created and produced not intentionally but more by coincidence, for various researchers, individuals and institutional bodies' who exchange ideas and knowledge in the preparation of accounting theory (Zancanaro 2021). It serves as an ultimate guide to the preparation of accounting theory. Ethical approach places importance on the concept of justice, fairness and truth which are considered as basic core of ethical approach. According

to Craig Deegan (2009) ethical approach is not an independent approach to the construction of accounting theory. This approach stated that financial reports should be presented in a true and fair manner without misrepresentation. Accounting data should be fair, impartial & unbiased without serving special interests. Other approaches that have emerged are behavioral approach, events approach, predictive and positive approach.

The behavioral approach considers human behavior in decision-making within accounting, taking into account users reactions to reports and their attitudes towards corporate reporting practices, materiality judgments, and financial statement data (Bello, 2022). As a matter of facts, the selection of an accounting technique must be judged in accordance with the objectives and behavior of the users of financial information (Zancanaro 2021). According to Omotayo and Osho, (2018) predictive approach aims to create an accounting theory by focusing on the logical nature of reporting methods that would be useful to manipulators, particularly in management accounting. This approach includes concepts like the effectual market hypothesis, chaos theory and Beta models. The positive approach, well-known as "the Rochester school of accounting," focuses on developing a positive theory of accounting to make clarifications on why accounting practices are as they are and the effects they have on resource utilization. The focus of a positivist framework is to find truth by describing the reality (Coetsee, 2010). It assumes that shareholders, regulators and managers are rational and seek to optimize their usefulness, this is best explained by Jensen (1976).

### **Reason why there are different Accounting Theories**

According to Bello (2022), different accounting theories are evolving, some of these theories are accepted while some are rejected and some are revised or modified. The reason why there are different accounting theories is that each theory was formulated to meet the needs of different users of accounting information and also formulated so as to keep bound with rising difficulty in business operation. Another reason why there are varieties of accounting theory is because there are no generally acceptable theories of accounting (Coetsee, 2010). Accounting does not have an encompassing theories, some accounting theories were borrowed from the fields of sciences, economics and sociology. There are various accounting theories some of the commonly used accounting theories are agency theory and positive accounting theory which are a branch of economics, grounded theory, structuration theory, institutional theory and constructionist theory which were borrowed from sociology, behavioral accounting theory, Chaos theory which is used to comprehend fraud in forensic accounting.

Furthermore, agency theory is a theory that clarifies the connection between the principals (shareholders) and the agents also known as the managers (Olagunju & Adenle, 2022). Agency theory is a theory that explains the relationship between shareholders and managers in an organization. It assumes that conflicts of interest arise due to the separation of control and ownership in the company. The theory seeks to resolve disputes over priorities between the two parties (Adenle et al., 2022). Agency theory endeavors to clarify and resolve disputes over the respective priorities between the principals and the agents (Voorn, et al., 2019). Positive accounting theory seeks to describe and forecast accounting practices of companies. The concentration of a positive accounting theory is to provide truth by narrating the reality and its fact and finding tools that gives the research process validity (Adebayo, et al., 2022). Grounded theory is a systematic procedure utilized in social sciences to develop theories through the systematic collection and analysis of data. It typically begins with a question or

qualitative data collection. (Patricia & Barry, 1986). The structuration theory in sociology presents a way of understanding human behavior by combining the influences of both structure and agency, which is referred to as the "duality of structure."

Constructionist learning emphasizes that learners build mental models to comprehend their surroundings. It supports student-centered, exploratory learning, where students leverage their existing knowledge to acquire additional knowledge (Alesandrini, & Larson, 2002). Institutional theorists maintain that the institutional setting can significantly impact the establishment of formal structures within an organization. Adhering to institutional guidelines is viewed as a way to achieve legitimacy, diminish uncertainty, and enhance the clarity of an organization's actions and operations. (Berthod, 2016). Behavioral accounting theory deals with the attitude and behavior of individuals when they are encountered with an accounting phenomenon which regulates the performance that they will show in decision-making (Angay, 2017). Chaos theory focuses on complex, nonlinear phenomena that are challenging to predict or manage, such as weather patterns, turbulence, and stock market fluctuations. These events are often described using fractal mathematics, which captures the infinite complexity of the natural world (Kattan, 2012).

### **Diversities in the use of Accounting Information**

Osho and Adindu, (2018) stated that accounting theory is useful for organizations and small scale businesses because it ensures that accounting information or records are being kept properly and also ensure that the organizations and small scale businesses comply with the standard accounting principles. Accounting theory emerges from the real world consisting of both users and non-users of accounting information. It is the value judgments of users and non-users about financial statements that generates theories for the formulation of accounting policies and standards. However, Riahi-Belkaoui (2004) suggests that there is no universally known "accounting theory," despite several attempts to develop one. Accounting information can have different meanings for different users, and similarly, accounting theories can be interpreted differently by different individuals, leading to misunderstandings. Osho and Ajayi (2018) explain that accounting information can be used diversely in various ways, which include:

#### **i. The unstable monetary unit in different countries**

The magnitude of inflation overtime and exchange rates are factors which can make global comparability of financial statements difficult (Millicham, 1990). Accounting transactions are usually measured in monetary terms, the exchange rate for all countries varies for example the amount for the exchange of dollars or pounds to naira may not have the same value overtime. Amending accounting records for inflation bring about the write-up of assets and related expenses. The instability in the rate of exchange is usually common among developing nations (Angus, 2014).

#### **ii. Cultural Diversity**

Stoner and colleagues (2002) argue that culture is a crucial factor in the development of organizations and their workforce. The beliefs and values of different cultures influence the way work is done. The impact of cultural imperialism by advanced nations on developing countries has had an effect on the early development of accounting practices (Angus, 2014). For instance, in Arabian countries with a predominantly Muslim population, there is a

reluctance to pay interest on loans and advances. Instead, they have their own established rules for Islamic financing.

**iii. Communication Barriers**

Communication barriers is one of the major draw backs of the early accounting development (Angus, 2014). The differences in the languages of different countries make it difficult for the formulation of universal accounting principles. The differences in languages will make it difficult for comparison of financial statements of different countries most especially if the countries prepare their financial statement in different languages using different accounting principles.

**iv. Diversity in the system of taxation**

There is diversity in the taxation system across different countries. In certain nations, taxation is based on financial statements, whereas in other countries, financial statements are modified for tax objectives and reported separately to the government, different from the financial reports given to shareholders.

**v. Complexity and differences in government policies**

The complexity and differences in government policies of nations regulates the scope, nature and the usage of accounting systems as well as how accounting information are being treated. Glautier and Underdown, (2001) stated that the status-quo of sovereign nations immunity determines how their accounting system is suitable for their political and socio-economic environment. Numerous independent countries develop accounting systems that are culturally aligned and distinct from those of other nations, making it challenging to compare them with one another. These accounting systems are unique to their respective cultures and have fewer points of reference with other countries.

**vi. Differences in the perspective of academics and practitioners**

There is a great superiority complex among academic accountants and practitioners. Practitioners are said to be more knowledgeable about accounting practices than the academic accountants. According to Angus (2014), the attitude of feeling superior to others still exists in the 21<sup>st</sup> century, causing two groups who should have worked together to develop the best accounting practices to lack shared goals and a common focus.

**vii. Judicial Application and Interpretation of Business Transactions**

There are various factors that influences the interpretation and the treatment of accounting information among nations, some of the factors are political factors, cultural factors, religion and environmental factors (Angus, 2014). Different businesses in several nations have their own way of interpreting their business transactions.

**Limitations of Accounting Theory**

Although accounting theory has numerous advantages, it also has significant limitations. For instance, accounting theory falls short in providing comprehensive explanations for all its practices. Additionally, accounting theory is utilitarian in nature, and its principles and conventions are constructed based on convenience rather than logical rules (Bello, 2022). Accounting theory is considered to prioritize practical accomplishments over deductive generalization (Littleton & Zimmerman, 2018). More so, accounting theories are easily

influenced by the practices and customs of different nations, this thus will limit the wider or globally acceptability of accounting theory (Mangu& Rahul, 2019). Another limitation of accounting theory is that the theories are not well defined and some of its assumptions are not realistic, the acceptance and development of accounting theory can easily be influence by government and legal requirements. There are several conflicting accounting theories and alternative treatment of similar items, this resulted in to serious problems for accountants because the conflicting theories do give rise to ambiguity and inconsistency in accounting practices, which will in turn leads to a serious challenge for the users of accounting information and accounting practitioners (Mangu& Rahul, 2019).

### **3. Research Methodology**

This research paper is a position paper that utilized an expository research design to examine existing literature. The study analyzed forty-five (45) secondary sources sourced from the internet, focusing on accounting theory formulation and variations in the utilization of accounting information. The literature reviewed included journals and articles from developed nations, Nigeria, and other developing countries, selected based on their relevance to the subject matter.

### **4. Findings and Discussion**

Results of this study after the extensive review of the concept of accounting theory formulation discovered that in accounting; practice comes before theory. Most the researchers concluded that accounting theory should align with practice so as to ensure effective financial reporting. The findings also discovered that the reason why there are different accounting theories is that each theory was formulated to meet the needs of different users of accounting information and also because of the absence of generally acceptable accounting theories. This is in support of the empirical findings of Adebayo et al. (2022); Bello, (2022); Coetsee (2010); Osho&Ajayi, (2018); Osho&Adindu, (2018, and Osho and Omotayo, (2018)who all stated that accounting theory can be misunderstood and mean different things to different people. They also stated that accounting theory are tailored to meet different users' needs. Riahi-Belkaoui (2004) confirms that no comprehensive theory of accounting has been developed and that different theories arise from the use of different approaches to the construction of accounting theory. Osho and Adebambo (2018) stated that theories are the backbone of accounting.

### **5. Conclusion and Recommendations**

This study examined potentially the approaches to the formulation of accounting theory, the reasons why accounting has many theories, the limitations of accounting theory and diversities in the usage of accounting information. The study agreed that there is no overall accepted accounting theory, the absence of an overall accepted accounting theory is the reason why we have different accounting theories today. Accounting theories are being formulated based on the user's information needs, the value judgement of the users and non-users of accounting information bring about the development of theories for the formulation of accounting policies and standards. Accounting theory is grounded on the normative and deductive approach, the normative approach focuses on result and describes what the theory should be, the modern view is that accounting theory is probable to be molded through normative approach (Abel et. al 2019; Deegan &Unerman, 2006). However, accounting information has varied meaning to different users. Inflation, cultural diversity, language barriers, government policies, taxation, differences in the interpretation of business



transactions and variances in the perspective of practicing accountants and academic accountants are some of the area of differences in the usage of accounting information. More so, as a result of conflicting accounting theories and alternative treatment of similar items, that has posed a serious challenge to accountants and other users, accounting bodies, legislators, academics, practitioners and standard setters are advised to develop a universal accounting theory that will meet every users of accounting information needs. The theory should be developed in such a way that it will be difficult to influence, this will ensure globally acceptability of the accounting theory. This study contributes to the prevailing literatures by reviewing extensively the methodologies to the formulation of accounting theories and examining the reasons why there are various accounting theories which most scholars who have reviewed accounting theory refused to discuss in the past years. The study also contributes to the prevailing literature by assessing the diversities in the usage of accounting information. The major limitation of this study was, the researchers fail to discuss the various accounting theories mentioned extensively. Based on this limitation, the study suggested that further studies can be conducted extensively on various accounting theories and their implications on accounting practices.

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