

Analytical Review Of Some Selected Accounting Theories

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Abstract

In this article I have analyzed and evaluated the seven theories of Financial Accounting as propounded by Harrison and Horngren (1998), Warren (1988), and Wood and Sangster (2002). The financial Accounting theories evaluated are: Theories of budgeting, theory of inventory accounting, generally accounting theory, accounting principles and inventory, accounting principles and concept, theory of depreciation, and theory of profitability for business managers. My comparison indicated common perspectives of financial accounting theories as important yardstick by which practices are measured and growth in theories which underpinned the conceptual framework of accounting. The theorists all concord with the ever-evolving nature of financial accounting theories but in contrast they disagreed on the concept of a generally accepted accounting theories. The analysis and evaluation carried out has cognitively enabled and empower me to critically assess the impact of accounting practice on business growth in Nigeria. The theories analyzed here have direct consequential effects on business growth and development in the country.

Keywords: *Financial Reporting; Transparency and Accountability; Theories; Budgeting and Financial Accounting*

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I. Overview

Proper bookkeeping is necessary for measurement of business progress, planning and ensuring control of business activities. Garuba and Donwa (2011) argued that the bane of business growth in Nigeria is the absence of dependable and reliable financial records. Poor financial records impede corporate planning, financial discipline, transparency, and accountability. Nigeria has recorded series of business failures especially in the banking sectors. Some of the incidences of business collapse in Nigeria were predicated on absence of sound financial records (Effiong, 2012). Due to the macroeconomic implications of business failure, it is imperative to study the effect of virile accounting culture on business performance in Nigeria with a view to promoting the culture of accountability and transparency.

In this paper, I analyzed theories of budgeting, general accounting theory, theory of income measurement, and theory of asset valuation by Wood and Sangster (2002); accounting principles and inventory, theory of inventory accounting and accounting principles and concepts by Harrison and Horngren (1998); and theory of depreciation and theory of profitability and liquidity by Warren (1988). I carried out a detailed evaluation of each theory, comparing and contrasting them in an integrated analysis. The result is a scholarly paper, on varying degrees of financial accounting theories, with emphasis on the development of accounting practice and business growth.

Theory Of Budgeting

Budgeting is the process of translating financial plans into blueprints of achievable actions. Budgeting gives financial direction to organizations, enables control and measurement of performance. Wood and Sangster (2002) stated that a budget is a quantitative financial plan. They argued further that the process of converting plans to budget is referred to as budgeting. Wood and Sangster (2002) held that budget guides an organization towards its objectives and that the process of a good budget should be as all-inclusive as much as possible, as there are some budgets that have been found to be more harmful than if there had not been any. Wood and Sangster (2002) argued that there had been some misconceptions about the purpose of budgeting in organizations. They posited that many people view budget as a straitjacket instead of a guide and therefore may exhibit undesirable response actions towards the budgeting process. Wood and Sangster (2002) identified four examples of negative reactions to the budgeting process as follows:

- A manager may abort salesman's unexpected bidding trip because the allocation for that heading had been exhausted, resulting in loss of highly profitable order;

- Management may disapprove overtime work because the vote for that heading is exhausted resulting in uncompleted work and consequent revocation of contract or payment of huge penalty;
- Management may resort to careless spending spree towards the end of the financial year in a bid to exhaust the unspent allocation; and
- Organizational activities may be stalled due to unavailability of budgeted funds.

Wood and Sangster (2002) suggested the panacea of negative reactions to budgets is to involve line managers in the preparation stage. They argued that when managers are involved in the budget preparations rather than having it imposed on them, there will be more commitment to its success. A successful budgetary control is therefore anchored on the initial active involvement of managers at the drafting stage. Wood and Sangster (2002) are of the opinion that every good budget has the two main objectives of planning and control. According to them budget planning is the properly coordinated and comprehensively drawn up business plan, with each part enjoying a harmony of belonging.

Wood and Sangster (2002) asserted that, budgetary control requires that managers constantly measure actual results against expectations and takes corrective actions against deviations. Wood and Sangster (2002) argued that, a good budgetary process recognizes the limiting factors that exist within the firm. Ogbenjuwa (2007) held that limiting factors are those items that exacts constraints on the achievement of set targets. It may be the productive capacity of the firm, cash flows constrain, manpower limitations, or technological shortcomings. Making sales forecast requires statistical estimates of the economic conditions of the market situation, or internal forecast based on past performance statistics. The process entails internal and external environmental scanning or analysis of internal strengths and weakness, and external threats and opportunities.

General Accounting Theory

In order to undertake the analysis of the various theories of accounting, there is a need to ascertain the existence of a generally accepted accounting theory. There is no agreement among scholars on any generally accepted accounting theory. Wood and Sangster (2002) argued, there is no generally accepted theory of accounting, and cautioned that theory taught in a vacuum does not cognitively equip students to understand its import. They however held that theory has a vital place in providing a general frame of reference for the development of new practices, procedures and benchmark by which standards of practices could be judged. Wood and Sangster (2002) posited, despite the absence of a generally accepted theory of accounting attempts have been made by scholars and practitioners to develop one. They argued that inductive approach was the first attempt at creating theory. The approach was to develop theory from observation of accounting practices, and analyzing for consistent patterns and themes. The attempt was in the hope of formulating theory from identified general principles. Wood and Sangster (2002) held that the inductive approach failed as it was impossible to develop principle for lack of consistent patterns due to divergent practices. The inductive approach according to Wood and Sangster (2002) failed because it was anchored on what the Accountants were doing rather than what they ought to be doing. Wood and Sangster (2002) argued further, the inductive approach would not have led to any important improvements in accounting practice as it was not tailored at building a reference point for measurement of accounting practices. The lack of uniform accounting practice made it difficult to develop meaningful theory there from.

Another attempt at developing accounting theory and formulating uniform accounting policy was the normative approach. Wood and Sangster (2002) held that the approach which dates back to the 1950s was aimed at substantially improving the accounting practice by focusing on what accountants should be doing. According to Wood and Sangster (2002) the normative approach also had elements of inductive approach as it derived its rules from the basis of logical reasoning. Wood and Sangster (2002) argued that, the two approaches exhibited positive synergies in the attempt to develop accounting theory but fell short of target due to the absence of general presence of accounting objectives. The inductive and normative approaches built on the premises of what accountants were doing and should be doing could not produce agreement on accounting theory formulation.

Theory of Income Measurement

Good accounting records helps entrepreneurs to properly account for income earned from operations. Managers match expenses against income of a given period to ascertain the viability of the business. The discussion of theory of income measurement by Wood and Sangster (2002) assumed income and net profit to constitute same meaning. Wood and Sangster (2002) provided methods for the calculation of net profit. They stated that the simplest method of income measurement would be 'sales income less expense incurred', which include the cost of the goods sold and other direct expenses. Wood and Sangster (2002) argued, profit is denoted as increase in wealth. Increase in wealth according to Wood and Sangster (2002) makes the business better off at the end of a period than it was at the beginning. Wood and Sangster (2002) further exhibited scholarly definition of profit as the maximum value a person may consume in a given period and still be well off at the end of same period as he was at the beginning.

They held further that profit is the maximum amount a company may distribute by way of dividend and still be as well off at the end of a period as it was at the beginning of same period. Wood and Sangster (2002) posited, there are two main approaches to wealth measurement. They stated that one approach was to deduct total liabilities from the total assets and the other approach was to measure the expected future benefits using the model of present value of expected future net cash-flows.

Theory of Assets Valuation

Valuation of assets is a contentious issue as users of financial statements insist a full disclosure of the basis for their presentations and values stated against various classes of assets in the balance sheets. Accountants use divergent methods and this have been at the center of interest to various standards setters locally and internationally. Wood and Sangster (2002) identified the historical cost model, the replacement cost, net realizable value, economic value, and deprive value methods as the different methods of assets valuation. According to Wood and Sangster (2002) historical cost which is the most commonly used method recognizes the original cost less amount of depreciation. The problem with historical cost model of asset valuation lies in the subjective decision regarding depreciation policy. Wood and Sangster (2002) argued, an assumption about the expected use of the assets, and consequently the depreciation rate is quite arbitrary, and lacking in standardization.

The demerits of historical cost model led to the adjusted historical cost as an alternative model. According to Wood and Sangster (2002) adjusted historical cost is a modification of historical cost method as they held that it was in answer to the problem of changes in the value of money rendering historical cost unrealistic and unsatisfactorily. Wood and Sangster (2002) argued, the replacement cost came as a means of valuing assets in line with what it would cost to replace the same assets. Wood and Sangster (2002) posited that the replacement cost is laden with the problem of over assumption of what it would cost in the market to actively replace the asset, as on-the-shelfed marked price may not truly be what a buyer could get the same asset due to effects of possible bargains and discounts.

The net realizable value is the amount estimated to be receivable from the outright sale of the asset less its' disposal cost. Economic value method according to Wood and Sangster (2002) anchored on the present value of future cash-flows associated with the assets while the deprival value is based on the premise of what the owner of the assets would be willing to receive in other to part with them. Wood and Sangster (2002) identified the key problems with each of the asset valuation models, holding there is lack of general consensus among accounting practitioners, emphasizing the lack of generally accepted theory of asset valuation.

Accounting Principles And Inventory

Accounting principles are the generally accepted accounting rules and procedures which have evolved over time. Harrison and Horngren (1998) argued that among the accounting principles which bear most direct relevance to inventories are consistency, disclosure materially, and conservation principles. They held that the consistency principle does not require the enforcement of uniform accounting methods across companies within the industry neither does the principle deter companies from changing their accounting methods, but that in doing so, it is imperative that such company disclose the effect of the change on the net income. Harrison and Horngren (1998) however posited that the object of consistency principle is that business should use the same accounting methods and procedure from year to year, as this will facilitate the ease of comparing financial statements for different periods.

In relation to inventories Harrison and Horngren (1998) held, a switch between different valuations of inventories such as from FIFO to LIFO or vice versa, could result in drastic distortion to the income results. Harrison and Horngren (1998) explained, a disclosure principle require that the financial statement of a company should contain enough information that would enable users of such information to take knowledgeable decisions. They stated that the qualities of a good financial report are relevance, reliability and comparability. This means a user of financial statement is expected to find the content relevant and informative, reliable, and comparable across industry and times. Harrison and Horngren (1998) posited, the disclosure principle require that the method of costing and valuation of inventory should be cleanly stated. A glaring example of bankers wrongly appraising the financial position of two companies using different inventory methods was exemplified by Harrison and Horngren (1998) to drive home the importance of disclosing requirement with regard to inventory.

Materiality enables business to accord recognition to transactions which are significant. According to Harrison and Horngren (1998) Materiality concept underpinned business practice of including into the financial statement items and transactions that bear significant effects on the financial results. What constitutes material, according to Harrison and Horngren (1998) is when its inclusion in the financial statement would change users' decisions regarding the business. The concept of materiality enables the Accountant to assess items that needed to be included or not included in the financial report. According to Harrison and Horngren (1998) the concept of materiality discharges Accountant from giving undue recognition to immaterial items, and spending time and

efforts in reporting in strict compliance with GAAP. Harrison and Horngren (1998) argued that the exclusion of immaterial items helps to reduce the cost of accounting information.

Decision as to what constitute materiality is largely dependent on the size of the firm. Harrison and Horngren (1998) argued, what is material to one firm may not be so viewed by another company of unequal size. They posited that asset value and net income largely determines what amounts to materiality. There is no accounting standard which determines the materiality of transaction in relation to any given value of asset and net income. Materiality therefore is left to the judgments of preparers of financial statements and management policy. Users of financial statements and auditors are expected to comprehend items of materiality in companies' statements on the basis of intuitions and common reasoning. Harrison and Horngren (1998) analyzed the theory of accounting conservatism, defining the concept as reporting items at amount which restrains overstating profits. It is a choice between presenting colorful and dismay performances. According to Harrison and Horngren (1998) conservative reporting avoids bloated profitability and takes full cognizance of possible loss situation.

Harrison and Horngren (1998) posited that the goal of conservatism is to present financial statement in a more realistic form and not in management's optimistic anticipation. It is framed in not anticipating gain and providing for possible losses. Accountants are to be guided by conservatism when recording asset at a lower of either of net realizable value or cost when they appeared unreasonably high.

Harrison and Horngren (1998) advanced the lower-of-cost-or-market rule model (LCM) for the valuation of inventory. The model states that inventory is to be valued at the lower of historical cost or its market value. Market value of inventory refers to the amount the company would pay to purchase the current inventory which is the current replacement cost. Harrison and Horngren (1998) argued, should the replacement cost falls below the historical cost of inventory then the value of inventory would be the historical cost, so as to badge against possible loss on inventory in line with GAAP provisions.

Theory of Inventory Management

Inventory management is one of the most important accounting functions that impact directly on business profitability. Harrison and Horngren (1998) posited, inventory play vital part in business accounting as business activities primarily revolve around inventory sales. The balance sheet usually carries inventory as the largest current asset, while it also dominates the income statement as cost of goods sold (inventory cost). Harrison and Horngren (1998) presented two inventory systems which a typical business must adopt. They held, a periodic inventory system is one in which a business takes stock of inventory and update its record at end of a period while in a perpetual inventory system a continuous inventory record is maintain. According to Harrison and Horngren (1998) either in periodic or perpetual inventory system, physical stock counts is needed for control purposes. Harrison and Horngren (1998) identified four inventory costing methods. They are the specific unit cost, weighted average cost, First-in, first-out (FIFO) and last-in, first-out (LIFO). FIFO and LIFO are more popular in usage than weighted average and specific unit costing systems.

According to Harrison and Horngren (1998) specific unit cost method is used by business engaged in selling discrete items that can be individually identified such as automobile and Jewels. The choice of inventory costing methods is a management policy informed by the need to respond to price fluctuation. Harrison and Horngren (1998) argued that when price are stable the determination of inventory cost is fairly easy but due to inflation and market distortion prices rarely remain stable. The FIFO method according to Harrison and Horngren (1998) assumes that the company keeps records of inventory purchased and costs the unit sold as the cost of the first inventory purchased. The value of the closing stock approximates the cost of the most recent inventory purchased. The LIFO method costs inventory sold at cost of the most recent purchased stock.

The value of the closing inventory approximates the cost of the earliest purchased items. During inflation the LIFO method is most preferred as the cost of goods sold approximate the current market price of the inventory. Management would therefore recover cost faster using LIFO method during inflation. FIFO method inflates the profit on sale of inventory and increase net income and profit attributable to stock owners than LIFO method. Harrison and Horngren (1998) argued that LIFO lowers taxable income and therefore is better for tax planning than FIFO. They held that FIFO however over states income during inventory period than LIFO. According Harrison and Horngren (1998) LIFO on the other hand allows for income management by managers. Harrison and Horngren (1998) analyzed the income and tax effects of inventory costing, holding that a company seeking to report higher profit during inflation would adopt FIFO but would also incur higher taxes. They held that if prices are falling LIFO would lead to higher income and higher taxes.

Accounting Principles and Concept

The science of Accounting is anchored and laid down guidelines. These rules are evolving and dynamic though they are nevertheless guides which dictate practices. Harrison and Horngren (1998) stated that accounting principles and concepts govern how financial information are measured, processed, and communicated in meaningful forms. They are referred to as the generally accepted accounting principles (GAAP). Harrison and

Hornrgren (1998) posited that the US Financial Accounting Standards Board (FASB), Securities and Exchange Commission (SEC), and the American Institute of Certified Public Accountants (AICPA) work in close collaboration in determining accounting practice in the United States. According to Harrison and Hornrgren (1998) FASB provides the conceptual framework upon which GAAP is aligned. Harrison and Hornrgren (1998) stated the main objective of financial report is to provide relevant reliable and comparable information.

The goals of every practicing Accountant therefore are to meet these qualities. Harrison and Hornrgren (1998) held that to comprehend discussion of generally accepted accounting principles it is necessary to understand some basic accounting concepts such as entity concept, reliability or objective principle, the cost principle, the going-concern concept and the stable-monetary unit concept. They held that these concepts and principles underline standard accounting practice.

Entity Concept

The entity concept recognizes the business as a separate unit from the owner. The business functions as a separate legal entity with artificial personality status. Accounting to Harrison and Hornrgren (1998) an accounting entity is an organization that stands as a separate economic unit. Harrison and Hornrgren (1998) held; from the perspective of accounting artificial boundaries bound each separate organization so as not to confuse its affairs with others within the industry or outside it. In other to effectively evaluate a business it needs to be held separate even if it is a part of a big organization. Harrison and Hornrgren (1998) argued that the affairs of an entity needed to be evaluated separately.

Reliability Principle

Users of financial information seek for reliable facts upon which to base their decisions. Reliability of accounting statement is fundamental to financial reporting. Harrison and Hornrgren (1998) argued, for accounting data to be reliable it must be objectively verifiable by independent analyst. They held that the accounting information evolves from objectively-documented evidence by preparers of financial statement. They argued that reliability principle ensures that accounting information are not based in subjective opinions of people as it could ginger disagreement and become non-dependable.

Cost Principle

This Principle asserts that assets purchased should be stated at its (historical cost) actual cost even when the price paid was more of the function of effective bargain. The principle requires that accounting records should perpetually present the asset at its historical cost for as long as it remains in use. According to Harrison and Hornrgren (1998) assets presentation at cost is opposed to the fair value model advocated by the International Financial Reporting Standard (IFRS). They argued that historical cost of assets is more reliable than its fair value which is subject to fluctuation due to market instability and inflation. Market price is subject to varying opinion and disputes while the cost is a fact of history that cannot be disputed.

The Going Concern Concept

The going concern assumes that the business will continue to operation in perpetuity. This underscores the reasons for presenting assets using the cost model. According to Harrison and Hornrgren (1998) under the going concern Accountants assume that the business will remain long enough to utilize its assets for operations. Harrison and Hornrgren (1998) argued that going concern values assets at historical cost but a business that is going out of business seeks to dispose all its assets and so will present them at current market price.

The Stable-Monetary-Unit Concept

Harrison and Hornrgren (1998) stated that the stable monetary unit concept enables Accountants to state financial reports prepared at diverse times in the same unit of currency without cognizant to effects of inflation. Accountants assume relative stability in the purchasing power of a given currency. Values of expenditures and assets are stated in the amount it was purchased or paid for, not minding the effects of changes in price arising from inflation. The assumption is that one dollar is stable in value of its purchasing power across years. Harrison and Hornrgren (1998) posited, the stable monetary unit concept is anchored on ignoring the effects of inflation in accounting records. Harrison and Hornrgren (1998) admitted that high inflationary trends demean the rationality of the stable monetary unit concept, citing South America where Accountants have resorted to making adjustments and reporting monetary amount by using the current buying power values referred to in Wood and Sangster (2002) as the Current Purchasing Power Accounting.

Theory of Depreciation

Any useful benefit to be derived from the discussion of depreciation requires the understanding of its relationship with fixed assets. Depreciation is an old-held accounting principle derived from prudence and

matching concepts. It is also aligned with the principle of conservatism. Warren (1988) defined depreciation as “the means by which the cost of the fixed asset is allocated over the various accounting periods which benefit from its use” (p.36). Warren (1988) argued, the rationale behind the concept of depreciation is to match the proportion of the fixed asset used up in earning the revenue for the period against same. The residual of the fixed asset after the depreciation charge is termed the net book value.

According to Warren (1988) net book value is that part of the fixed asset not yet utilized in the production of the revenue to the enterprises. It is therefore held against future revenue yielding operations. The net book value shall therefore be carried forward to be allocated to future periods for the purpose of generating more revenue. Warren (1988) held, one unique characteristic of the fixed asset is that it is held for usage rather than for sale. Their lives extend beyond one accounting year. Warren (1988) gave examples of fixed assets as buildings, plant and machinery, and motor vehicles. Fixed assets are of longer duration than current assets as such they are not written off the profit and loss accounts as purchases or consumables. They are therefore not considered as operational expenses but are capitalized in the accounts. The effect is that they are not considered as being expended in one accounting year.

The concept of depreciation enables Accountants to allocate the cost of the fixed assets on a gradual basis across many years of the assets’ useful life. According to Warren (1988) the relationship between fixed assets and depreciation indicates the relative age of the asset. This is because the higher the accumulated depreciation the older the asset is likely to be. This relationship comes out figuratively in the comparativeness of accumulated depreciation to the original cost of the asset. Depreciation is a prudent measure against the need to replace the fixed asset in the future. The charge is a provision for the eventual asset replacement. Should management fail to provide for depreciation, it means it has not made provision for the eventual demise of the existing asset from constant use. When suddenly it becomes unavoidable to replace the worn-out asset, there may not be funds put aside for this purpose.

On another note if the Accountant should charge all the cost of the asset against the profit and loss of the year of purchase, there would be heavy burden against that year’s profit and loss, resulting in possible loss, whereas the benefits will accrue to many future years. The consequences are that those benefiting years would record over-bloated revenue. Such treatment would result in distortions to the accounts. Depreciation, according to Warren (1988) is the result of wear and tear in the value of the fixed assets consequent on usage. Warren (1988) posited, there are a number of methods of depreciation and that the choice is a management policy which varies across industries. Warren (1988) argued, the ideal basis for depreciation charge is the usage and the length of life of the asset.

He posited that whatever method is chosen, it is based on estimation and expectation which are subject to circumstances that may necessitate the review of the initial estimates. Warren (1988) argued, depreciation ensures that funds are retained for the eventual replacement of assets, and that such funds must be available in liquid form when the needs arose. Warren (1988) however held, the effect of inflation often makes unfruitful the prudent concept of depreciation, as funds set aside may lose its purchasing power to replace the needed assets. He therefore held that the concept of depreciation then only serves to match expenses against the revenue.

Theory of Profitability: Analysis for Business Managers

Warren (1988) illustrated the theory of profitability with practical example taken from the account statements of a hypothetical company “The Dovetails Ltd”. Warren (1988) made strong case for analysis of accounting information holding that analysis makes information useful. According to Warren (1988) “A young man weighs 14 stones” in itself makes no sense unless we are informed of his age and height. Processing the information of the man’s weight, age, and height would be more useful to readers than just a piece of information about his weight. It would further be more useful if we knew that the same Young man weighted 19 stones twelve months ago. Warren (1988) stated, putting these pieces of information together and relating them amounts to analysis. He argued that individual pieces of information taken out of context are of limited value.

According to Warren (1988) processing accounting information involves identifying relationship between items shown in the accounts and expressing such relationship to make it meaningful and useful to users of financial reports. Comparing pieces of information against one another enables us to know if the business is making progress as against previous period or as against other businesses in the industry. Warren (1988) posited, one of the best ways a business could evaluate its performance is by analyzing the published accounts of its immediate competitors. When analysis is made and compared with competitors’ performance it is termed industrial analysis but when results are compared with other periods it is termed trend analysis, but ratio analysis enables managers to relate items in the financial statement against each other.

Warren (1988) argued, another source of analysis is that which takes place covertly by the business Accountant. Warren (1988) stated, as the Accountant is privilege to act for different clients, he/she is able to obtain wider perspectives of the average performance of firms within the industry against which he/she can measure each company’s result. According to Warren (1988) whatever the policy of the business, analysis of

accounts will highlight areas of weakness for managerial actions. Warren (1988) posited, business objectives are diverse as to its strategic policies. A business plan according to Warren (1988) may be growth or survival, expansion or containment, profit or larger share of the market, or liquidity. Warren (1988) argued, to achieve any of these objectives there is a need for a careful analysis of the business accounts.

Profitability

A company which is profit driven is careful to analyze its financial statement in order to assess sustained operating profit to fund its operations and returns to stock holders. Warren (1988) stated, retained earnings indicate the extent management has made efforts to set aside funds for future expansion. Except the business has operated at a profit there will be no funds for future expansion. According to Warren (1988) shareholders will be partially interested on the profit after tax and extra ordinary items as that will be the profit available for dividend distribution. Operating profit before tax indicates overall business performance and will be of particular interest to managers and tax authorities. Warren (1988) posited, profit does not only come from sales but also from effective use of capital.

Warren (1988) argued, a given operating profit is not sufficient basis to appraise a company's performance unless we are informed of the amount invested to generate that profit. He stated that two companies earning £1000 each is not sufficient information for effective comparison but if further information indicates that one company had earned £1000 from £500 invested and the other earned £1000 from £50000 investment then we can say emphatically that the first company has performed better. Warren (1988) posited, in order to assess business performance profit must be related to the resource used in earning them. Typically, profits are generated from effective use of all classes of capital. Warren, (1988) therefore held, full value of resources available to management should be accounted for.

He argued that all classes of loan and equity, including all the funds at disposal of management should be included for the purpose assessing profitability. Warren (1988) submitted that current liability though a source of finance, is excluded from the calculation of the amount of capital employed because they are available on a short term basis and should be offset against the current asset, the result being working capital which then is aggregated with fixed assets and investment to derive the total capital employed. Warren (1988) held, management's objectives should be to maximize profit through sale and minimize capital employed in order to improve profitability. Warren (1988) argued that analysis of accounting information provide basis by which management can assess business performance.

According to Warren (1988) profit on a given volume of sales can be improved upon as management increases sales or reduces operating cost. Warren (1988) asserted that interest of sale on capital employed can be made effective as management increases sales or reduced capital employed.

Liquidity

Warren (1988) asserted that a profitable business may not be liquid. Liquidity is a state of preparedness to meet current financial obligations as at when due. It simply means the ability to pay liabilities on demand. Warren (1988) argued "profitability is important but liquidity is critically" (p.103). He posited, profitability is crucial for business survival in the long run but the immediate effects of liquidity problems can cripple the entire business entity. Liquidity problem could expose a firm to legal tussle as unpaid creditors may initiate bankruptcy proceedings and subsequent liquidation of the entity. Effective working capital management, according to Warren (1988) is the immediate response to liquidity problems. He argued that when funds are tied down in working capital, there are two options left for the business manager in need of improving the liquidity status of the firm. Warren (1988) argued, the business may take extended credits from suppliers, or resort to taking bank overdraft. Warren cautioned that bank overdraft however has the incidental cost of interest payment whereas credit extension from suppliers is generally interest free. The point of caution according to Warren (1988) is, both credit extension and bank overdraft would make funds available to support the working capital as viable option but could lead to increased liabilities which have to be paid in a short while. Warren (1988) posited however that as a company takes more credit from suppliers less of its own money is needed for stock financing and could be channeled to other operating activities. According to Warren (1988) such arrangement may be good in terms of minimizing the working capital in a short run but when credits are held down beyond four months suppliers would become uncomfortable about the company's liquidity position.

Warren (1988) argued the higher the level of creditors the greater the risk of default in payment leading to loss of creditors' confidence. Loss of creditors confidence may be followed by panic demands for credit redemption at the same time, putting the company in a severe liquidity crunch as it would not have enough money to refund all creditors at the same time, there is the likelihood of running into legal battles. To guard against liquidity problem Warren (1988) advocated a company should constantly assess its liquidity profile by calculating its cash-flows and ability to meet short-term obligations. The techniques to do so, according to Warren (1988) are the current ratio, quick ratio analysis and cash-flow forecasts.

Current ratio compares the current assets against current liabilities. Warren (1988) argued current ratio provides a general assessment of the readiness to meet short-term obligations. Generally, a ratio of 2:1 current assets to current liabilities is assumed to be a good measure or readiness to meet current obligations. It means that the current assets when converted to cash can pay off the current liabilities twice. Warren (1988) however posited current ratio is an arbitrary measure of liquidity as it does not consider the liquidity of the constituents of the current assets. He argued that cash tied down in stock may not be readily available to pay off liabilities. This is because stocks have to be sold and this may take sometimes.

The shortcoming of current ratio in truly appraising the liquidating status of a business leads to the consideration of the concept of quick ratio, which excludes stocks from the calculation of current assets. Warren (1988) posited, traditionally a current ratio of 2.1 and quick ratio of 1.0 is considered reasonable. He contended further that liquidity crisis usually occur very quickly leaving no much time for managers to seek for possible solutions. He argued that to solve the problem of liquidity is to quickly inject cash which may not be readily available. Stock may not be easily disposable in a hurry and debtors may not all be realized in a short time, so both the current ratio and the quick ratio may avail the manager false sense of confidence in handling liquidity crisis. Warren (1988) argued, the most effective way is to plan ahead and ensure that there are sufficient funds to meet short term obligations. He held that the cash flow forecast is the most enduring plan against liquidity crisis.

According to Warren (1988) cash flow forecast is a technique that no manager can afford to overlook. Warren (1988) cautioned, even the most productive business may face liquidity crisis. He held that hedging against its occurring by proactive planning is the best way to overcome it. Cash flow forecast is a technique whereby a business anticipates its cash inflows and outflows, and plans its activities in such a way that there won't be idle cash tied down and there would be ready funds to meet current obligation as it falls due. It involves manipulating its productive activities, sales levels, stock holdings, and making adequate provisions for meeting operating expenses.

Evaluation

Warren's (1988) argument on the importance of financial analysis was convincing as he lacerated his points with illustrations, examples, and powerfully demonstrated the usefulness of analysis as specialized language of accounting information communication. He made succinct points that without analysis, accounting information may be deceptive and misleading. Warren postulation was rendered in simply flowing English, with easy-to-comprehend practical examples. The discussion of the theory of profitability brought to fore certain accounting mechanics used in deriving companies' profit. Warren (1988) demonstrated clearly that beyond increasing sales there are other vital considerations such as efficiency of capital employed to achieve profitability objectives. For consistency, Warren (1988) used a set of financial statement of a company for practical demonstration of diverse topics in his presentation.

The piece meal approach and application of accounting theories and principles employed to dissert the contents of the financial statement made the discussion highly engaging. Warren (1988) was able to clearly show the relationship between liquidity and efficient working capital management. The step by step appraisal of the current ratio and the quick ratio carried out by Warren (1988) laid an appetizing background for quick digestion of his discussion on cash-flows forecast. Warren (1988) had proven his statements true when he stated that his postulation would "serve as a guide to a practical understanding of what accounting is all about" (P.vii).

Warren (1988) closed the discussions on profitability and liquidity, showing a clear path of relationship between the two constructs and suggested how management may strike equilibrium between the two vital business objectives.

Evaluation of Accounting Theory

Wood and Sangster (2002) compared inductive and normative approaches to building a body of theoretical knowledge of Accounting, noting that the normative approach provided a better benchmark for measuring accounting practice. Wood and Sangster (2002) argued the inductive approach was more of postmortem as it failed short of setting standards for appraisal of practices. They demonstrated strong analytical understanding of problems which undergird the failures of the two approaches in developing acceptable theoretical landscapes for practicing accountants. Wood and Sangster's (2002) panacea to developing an enduring accounting theory is a pointer to the need and emergence of generally accepted accounting principles upon which many local accounting standards and the International Financial Reporting Standards drew inspirations.

Wood and Sangster's (2002) discussion of income measurement left knowledge gaps. They held that income and net profit are the same things, but Ogbenjuwa (2007) argued, net profit is the residual of income after deduction of operational expenses. Wood and Sangster's (2002) explanation of net profit as increase in wealth and the maximum value a person may consume and still be well off at the end of a given period as at the beginning of same, is well informative. The explanation is simple, well captivating, and easy to comprehend. Wealth

measurement according to Wood and Sangster's (2002) takes two approaches, either by looking at it from net assets perspective or by resort to using net present value approach. Wood and Sangster (2002) clearly presented the approach to wealth calculation in a manner that conveys the understanding of wealth from the perspectives of shareholders' funds and the discounted value of future benefits to business owners. The explanation is scholarly, relevant, and cognitively sound.

Contrary to the position of Wood and Sangster (2002) that the demerit of historical cost model in the valuation of assets lie in the subjectivity with regard to depreciation rates which management arbitrary set, Harrison and Horngren (1998) argued, depreciation rates have become standardized with the institutionalization and internationalization of accounting standards. Wood and Sangster (2002) did not discuss the adjusted historical cost exhaustively as readers could be left to deduce meanings from the understanding of the historical cost model. Wood and Sangster (2002) did a very good analysis of the various inhibiting demerits of each asset valuation methods and re-emphasized the absence of a generally accepted theory of assets valuation. They however failed to advance any discussion on fair value accounting with regard to assets valuation as contained in the International Accounting Standards IAS 39.

Evaluation of Theory of Accounting Principles

Harrison and Horngren (1998) identified the usefulness of having generally accepted accounting principles to provide rules and guidelines for the practice of accounting. Harrison and Horngren (1998) restricted their discussion on generally accepted accounting standards and the formulation of accounting standard to the United States and failed to appraise other Local GAAPs and the International Accounting Standards. By doing this, they had limited the usefulness of their discussion and lost the benefits accruing from more elaborate discuss on the existing accounting frameworks across the globe. Harrison and Horngren (1998) 'struck the bull in the eye' by concisely identifying the overall objectives of every financial report as the provision of relevant, reliable, and comparable accounting information. Harrison and Horngren's (1998) discussion of some basic accounting concepts as prelude to understanding the generally accepted accounting methods is very instructive and down to earth.

The dialogue on accounting concept was conveyed in a simple and well-articulated structure. Harrison and Horngren (1998) however were not exhaustive in their discussion of accounting concept. Important concepts such as matching concepts, accrual concept, money measuring concept, and dual concept were left out and readers would wonder what informed their selection of entity, reliability, going concern, stable monetary unit, and cost concepts/ principles for discussion. Nothing support the efficacies of the cost principle in asset valuation more when Harrison and Horngren (1998) argued, cost is a fact of history as opposed to market price which is subject to varying opinions. Harrison and Horngren (1998) further validated the cost principle by holding that the concept of going concern presuppose that assets be valued at cost and not market price because the business is assumed to be in perpetuity and not holding assets for eventual disposal and liquidation.

Harrison and Horngren's (1998) discussion on stable-monetary unit concept would have been enriched by clearer and contrasting analysis of the current cost accounting and current purchasing power accounting instead of making a passing comment on them. Harrison and Horngren (1998) advanced two statements containing seeming contradictions, when they stated that the concept of consistency does not imply that companies are not deterred from changing accounting methods yet they held that the concept demands that business should adopt the same accounting methods and procedures from year to year in order to facilitate comparability. Harrison and Horngren (1998) cautioned rightly when they stated that a switch between inventory valuation methods could result in a drastic distortion in the reported income. A discussion on inventory management by Harrison and Horngren (1998) left out stock holding policies such as economic order quantity, stock levels, and determinations of minimum and maximum stock levels.

Comparing and Contrasting the Theories

Wood and Sangster (2002) stated there had not been any generally accepted accounting theory by which practices would be assessed. They argued there had been efforts at development a general theory of accounting but there had never been a consensus, as such accounting standards have continued to evolve overtime with consistent modifications as the occasions demand, but Harrison and Horngren (1998) contested accounting theories and principles have stood the test of time and are accepted as the generally accepted accounting rules and procedures which undergird the development of accounting standards locally and internationally. Warren (1988) however did not engage on theoretical dialogue but flatly stated that the concept of profitability and liquidity are valid theories that underpinned the understanding of company's objectives.

Harrison and Horngren (1998) listed consistency, going concern, stable monetary unit, disclosure, and materiality as the main principles of accounting to the exclusion of other concepts such as matching concept, money measuring concept, dual concept and accrual concept which were all acknowledged by Wood and Sangster (2002). Harrison and Horngren (1998) argued stock is the largest component of working capital items in

agreement with Warren (1988) who held that effective stock management is vital to realizing the profitability objectives of a company. Harrison and Horngren (1998) offered surface discussions on inventory costing but avoided a touch on inventory policy and the relationship to working capital management. Warren (1988) however clearly stated that ineffective inventory management could impair profitability and jeopardize company's liquidity. Harrison and Horngren (1998) contradicted themselves when they argued that there is no generally accepted accounting rules and later on admitted that accounting principles and concept provide rules that governs how financial information are measured, processed, and communicated to users and other stakeholders.

Wood and Sangster (2002) posited profit is denoted as increase in wealth but Warren (1988) did not offer any definition of profitability but went on to analyze the components of profit from the perspectives of providers of funds. The dialogical approaches of Warren (1988) and Wood and Sangster (2002) achieved confluence in their analytical work-sheets of company's profitability, liquidity and ratio analysis. They both made useful contributions to advancing knowledge of working capital management while Harrison and Horngren's (1998) contribution on inventory management was a useful input in promoting the understanding of working capital management.

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