



Unconditional Accounting Conservatism and Corporate Tax Avoidance: Evidence from Listed Insurance Firms in Nigeria

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Abstract

The article explores the unique place of unconditional accounting conservatism in the formation of corporate tax avoidance plans in the insurance industry of Nigeria. In contrast to its conditional counterpart, unconditional conservatism involves an ex-ante systematic understatement of net assets, based on accounting procedures that do not depend on the news about economic performance in the future. The study is based on the Positive Accounting Theory and, particularly, on the taxation discussion of the conservatism, and it states that the unconditional conservatism is the tool of strategic deferral of the tax payments in the long term. The study uses the Autoregressive Distributed Lag (ARDL) bounds testing model using a panel dataset of ten insurance companies that are listed on the Nigerian Exchange Group (NGX) between 2010 and 2023. Unconditional conservatism is measured using the Market to Book (MTB) ratio and tax avoidance is measured using the Cash Effective Tax Rate (Cash ETR) and the measure of Henry and Sansing (H&S). The results show that there is a complex, two-dimensional association: unconditional conservatism shows significant negative correlation with the Cash ETR and significant positive correlation with the H&S metric. This implies that unconditional conservatism is successful in the sense that it lowers the existing tax burden (reduces cash ETR) but, at the same time, it increases the gap between the book and tax income, the H&S measure. The paper concludes that unconditional conservatism is a planned, tactical tax planning practice in the Nigerian insurance sector, which allows companies to postpone tax payments and earn incomes in a seamless manner in the long run. Such perceptions are important to tax authorities, regulators and standard-setters in interpreting the tax implications of conservative financial reporting.

Keywords:

Unconditional Conservatism, Tax Avoidance, Tax Deferral, Market-to-Book Ratio, Positive Accounting Theory, Insurance Firms, Nigeria, ARDL.

1. Introduction

Corporate tax avoidance is still a defining characteristic of the global economic environment, which has significant effects on the national revenues and economic justice (Crivelli et al., 2016). In less developed economies like Nigeria, with a narrow tax base, and with the economy largely dependent on corporate tax revenues, researching the motivation behind tax avoidance moves beyond scholarly research and becomes a fiscally vital issue (Besley and Persson, 2014). A lot of literature has been done on the aspect of governance, ownership structure, and executive incentive on tax planning but the impact of individual financial reporting principle needs to be investigated into more. One of these principles is accounting conservatism, which promotes discretion in the recognition of assets and revenues. Academic literature is becoming more attentive to the fact that conservatism is not a unified idea. The point of contention is the asymmetrical timeliness of loss recognition, which is conditional conservatism as opposed to unconditional conservatism, which is an understatement of net assets which is systematic and does not depend on the news (Beaver and Ryan, 2005; Ball and Shivakumar, 2005). The latter has not been a well-studied subject, with much of the literature on tax-avoidance focusing on the former, especially when it comes to emerging-market situations.

Unconditional conservatism is based on accounting practices that lead to a reduced book value of assets at time of inception regardless of the later economic developments. The examples are immediate expensing of internally generated intangible assets, accelerated depreciation, and historical-cost accounting of assets that are appreciating (Ryan, 2006). This pre-emptive bias leaves behind a kind of hidden reserves, which are able to be released in later periods in order to even out earnings. On a taxation point of view, this practice is very significant. Taxation is one of the main determinants of unconditional conservatism as Watts (2003a) and Qiang (2007) indicate. Tax deductions can also be accelerated by firms by accelerating recognition of expenses incurred to serve book purposes (e.g. by using accelerated depreciation), thus deferring payment to tax and reducing the present value of their tax payable.

The relationship is important to study in Nigeria in the insurance sector. The industry is marked by stiff competition, high regulatory capital standards and the presence of an intricate network of liabilities. The strategic imperative in such an environment is the capacity to handle earnings easily and maximise cash flows by planning taxes. Unconditional conservative policies, including aggressively writing down assets, can have a direct effect on the taxable income of an insurer as well as the reported solvency margins.

Although of theoretical significance, little and indirect empirical evidence exists on the relationship between unconditional conservatism and tax avoidance. Previous studies in Nigeria have been done on conservatism as an aggregate scale or have addressed the conditional form of conservatism (Hamid et al., 2023; Suleiman, 2020). This leaves a massive gap in literature. Does the methodology-based and systematic aspect of unconditional conservatism make it a successful instrument of tax avoidance than the incidental conditional conservatism? What are the effects of it on the various indicators of tax avoidance?

This research paper aims to provide answers to these questions through the lens of narrowed empirical investigation of the long-run association between unconditional accounting

conservatism and corporate tax avoidance in listed Nigerian insurance companies. The question that informs the research is as follows: what is the strong long-run correlation between unconditional conservatism and corporate tax avoidance, both through the Cash ETR and the H&S measure, in the insurance companies of Nigeria?

This study has a number of contributions. First, it offers one of the earliest targeted studies of tax implications of unconditional conservatism in an African emerging market. Second, it uses a strong econometric model (ARDL) to develop a long-run equilibrium relationship. Third, the application of two different proxies of tax avoidance indicates the complex and subtle nature of the effect of unconditional conservatism on the tax position of a firm. The results will inform the Federal Inland Revenue Service (FIRS) about how the accounting policy decisions can be used to indicate tax strategy, the National Insurance Commission (NAICOM) about the interaction between reporting conservatism and solvency management, and the managers of the firms about the trade-offs in the accounting decisions they make.

2. Literature Review and Theoretical Framework

2.1. Conceptualizing Unconditional Accounting Conservatism

Unconditional conservatism, or ex-ante or news-independent conservatism, is a type of accounting prudence, and is incorporated into the choice of accounting methodologies when the assets and liabilities are established. According to Beaver and Ryan (2005, p. 269), the phenomenon is considered to be the understatement of the book value of net assets against their economic value at the recognition date. The understatement is not a reaction to certain economic incidences; it is part of the financial reporting system, which is defined by predetermined rules and policy decisions of the manager.

The major features and examples are; systematic understatements that entail the understatement of the reported value of net assets is a consistent trend; the book of value of equity is always lower than the market value; News-Independence where change in value is not contingent on the arrival of bad news, as is the case of conditional conservatism; that is, the effect of conservatism is uniform regardless of the current economic performance of the firm.

Other common examples include; expensing all expenses on research and development (R&D) immediately, even when the project is likely to benefit the economy in the future; acceleration in the depreciation of property, plant and equipment that is more than what the economic consumption of the property, plant and equipment is; the rule of lower-of-cost, or net realizable value of the inventory, which is biased to the downside and; historical cost accounting, which does not reflect the upward re-valuation of assets.

In this regard, the main measure of unconditional conservatism that will be used in the present study is the Market-to-Book (MTB) ratio (Beaver and Ryan, 2000; Feltham and Ohlson, 1995). The ratio is calculated as market value of equity/book value of equity. A large MTB ratio shows that there is a significant gap between the valuation of the market of the growth opportunities of the firm and assets-in-place and their historical cost, thus, reflecting the direct expression of unconditional conservatism. The consistently high MTB ratio indicates that the accounting

policies of the firm have been systematically understating the net asset base of the firm in their accounting.

2.2 Corporate Tax Avoidance

Tax avoidance entails legal practices that are aimed at cutting down the tax of a firm. This analysis is based on two complementary proxies:

Cash Effective Tax Rate (Cash ETR): This is a value using the real cash taxes paid in comparison to the accounting income before tax. A smaller Cash ETR shows that it is more successful in decreasing its current tax outflows.

Henry and Sansing (H&S) Measure: This measure is a difference between the real cash taxes paid and the anticipated tax liability (pre-tax income x statutory rate) divided by total assets. It is also supposed to be less sensitive to the size and profitability of firms and is claimed to cover a wider range of tax avoidance activities, including those that produce book-tax differences (Henry and Sansing, 2014).

2.3 Theoretical Background: the Positive Accounting Theory and Taxation Hypothesis.

The most interesting theoretical model that connects unconditional conservatism to tax avoidance is provided by the Positive Accounting Theory (PAT), namely the hypothesis on taxation, which was originally formalized by Watts (2003a). PAT attempts to describe and forecast the accounting policy decisions based on the incentives of managers and firms. Watts (2003a) has found four main rationales of accounting conservatism, namely, contracting, litigation, regulation and taxation. His view was that as long as contracting is the major cause of conditional conservatism, so is taxation the major cause of unconditional conservatism. The reasoning of the taxation hypothesis is simple and strong:

First is the Deferral of Tax Payments: Firms have an incentive to defer taxable income to later periods, which will lower the value of tax payments at the present value. Unconditional conservatism provides a direct process of this deferral. In addition is the accelerated Deductions. Firms that choose accounting policies that accelerate the recognition of expenses in financial reporting (e.g., expensing R&D, the use of accelerated depreciation) can use the same approach in tax reporting or at least provide the same justification. The outcome is the quicker deductions of tax and reduced taxable income during the current period. Furthermore, there is the Establishment of Deferred Tax Assets. Vigorous expense recognition may give rise to or increase temporary differences, which create deferred tax assets, and thus, reflect future tax savings.

Moreover, earnings smoothing and hidden reserves occur. Here, assets are systematically understated creating the hidden reserves. During profitable years, companies can accelerate depreciation or can release other types of reserves but this does not impact taxable income (assuming that tax methodology remains unchanged) but it does boost accounting income, and this reduces the current ETR.

As Qiang (2007, p. 760) empirically showed, an increase in tax costs causes unconditional conservatism. The reason behind this is that unconditional conservatism is a relatively cheap and predictable way of postponing tax expenses. It is not volatile as the conditional conservatism and it is not dependent on the possible occurrence of bad news that will cause tax deductions.

In its turn, according to the taxation hypothesis of PAT, we assume a very obvious strategic connection: that unconditional conservatism is a deliberate tool used by the firms in their attempt to facilitate tax avoidance, and that this is effected by the very process of long-term tax deferral. This is what the testable hypotheses are based on.

2.4 Empirical Review and Hypothesis Development.

To the best of the researcher's knowledge, there is a paucity of empirical studies that actually test the unconditional conservatism-tax avoidance relationship in the insurance sector in Nigeria; however, there is evidence in support of it. Kim and Jung (2007) examined Korean companies and found that the unconditional conservatism (instead of conditional conservatism) had a positive correlation with the tax burden of a firm which was more pronounced when book-tax conformity was high. This observation is consistent with the idea that the book and tax incomes are closely related and thus the conservative accounting can directly reduce the taxable income.

In an in-depth analysis, Qiang (2007) discovered that the tax costs were a major determinant of unconditional conservatism and not of conditional conservatism. She claimed that unconditional conservatism is the right instrument to use in tax-induced reporting due to its cheaper implementation and the creation of a fixed and predictable approach to income deferral.

In the Nigerian case, the general thesis shows that there is a strong positive correlation between the measure of Henry and Sansing of tax avoidance and unconditional conservatism (UCC). This implies that strategic understatement of assets is one of the major predictors of aggressive tax positions as reflected in this measure.

Therefore, according to a strong theoretical framework of the PAT hypothesis of taxation and the supporting empirical data, the following hypotheses are developed:

H1: There is no significant relationship between Unconditional conservatism and cash effective tax rate of the insurance firms in Nigeria.

H2: There is no significant relationship between Unconditional conservatism and Sansing (H&S) measure of tax avoidance among insurance companies in Nigeria.

Therefore, key assumptions from these hypotheses are that,

H1: The more unconditional conservatism is high; the less current tax payments (i.e. a lower Cash ETR) will be.

H2 is an assumption that the identical accounting policy will produce a negative H&S value, which will indicate that the firm will pay much less tax than it would under the accounting income and the rate stipulated in the statute.

3. Methodology

3.1. Research Design and Data Source

The research design to be used in this study is a longitudinal panel, ex-post facto research design that is quantitative in nature. The population and sampling strategy are the same as in the previous study: all insurance companies that have been listed on the Nigerian Exchange Group (NGX) between 2010 and 2023 and met the requirements of the availability of data and permanent presence were included. Thus, the panel of balanced 10 firms and 137 firm-years was created. The audited annual reports and accounts of the sampled firms were manually extracted to get the data.

3.2. Variable Measurement

3.2.1 Dependent Variable:

- a) Tax Avoidance (TAV) Given as Cash Effective Tax rate (Cash ETR):
Cash Taxes Paid/ Pre-tax Accounting Income.
- b) Measure of Henry and Sansing (H&S) given as:
(Cash Taxes Paid -(Pre-tax Income x Statutory Tax Rate)/Total Assets).

3.2.2 Independent Variable: Unconditional Conservatism (UCC).

Determined by the Market-to-Book (MTB) Ratio (Beaver, 2000 and Ahmed, 2007). Calculated as:

MTB= Market Capitalization/ Book Value of Equity.

An increased ratio of MTB is an indication of an increased level of unconditionally conservatism since the market value is higher than the conservatively stated book value by a higher proportion.

3.2.3 Controlling Variable: Conditional Conservatism (CDC)

To separate the influence of unconditional conservatism, conditional conservatism is calculated on the basis of the Basu (1997) model by calculating the firm-year C_Score, which is as described above.

3.3. Model Specification and Technique of Analysis

In order to determine the long-run relationship, again, the study applies the Autoregressive Distributed Lag (ARDL) bounds testing methodology that was developed by Pesaran et al. (2001). This is an especially appropriate approach when dealing with a combination of I(0) and I(1) variables as preliminary Augmented Dickey-Fuller (ADF) unit-root tests have already verified.

The general ARDL model specifications are:

Model 1 (Dependent Variable: Cash ETR):

$$\Delta \text{Cash ETR}_t = \alpha_0 + \sum \alpha_1 i \Delta \text{Cash ETR}_{t-i} + \sum \alpha_2 i \Delta \text{UCC}_{t-i} + \sum \alpha_3 i \Delta \text{CDC}_{t-i} + \lambda_1 \text{Cash ETR}_{t-1} + \lambda_2 \text{UCC}_{t-1} + \lambda_3 \text{CDC}_{t-1} + \varepsilon_t$$

Model 2 (Dependent Variable: H&S):

$$\Delta H\&S_t = \beta_0 + \Sigma \beta_{1i} \Delta H\&S_{t-i} + \Sigma \beta_{2i} \Delta UCC_{t-i} + \Sigma \beta_{3i} \Delta CDC_{t-i} + \delta_1 H\&S_{t-1} + \delta_2 UCC_{t-1} + \delta_3 CDC_{t-1} + \mu_t$$

The existence of a long-run relationship (cointegration) is tested using the bounds F-test on the lagged level variables ($H_0: \lambda_1 = \lambda_2 = \lambda_3 = 0$). If cointegration is established, the long-run coefficients are estimated, and the short-run Error Correction Model (ECM) is derived to show the speed of adjustment back to equilibrium.

4. Results and Discussion**4.1. Descriptive Statistics and Preliminary Analysis**

Table 1 presents the descriptive statistics for the key variables.

Table 1: Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std. Dev.	Observations
Cash ETR	0.744	0.135	42.174	-3.154	4.486	137
H&S (N'000)	101,952	-196	22,700,000	-2,380,000	1,960,000	137
UCC (MTB)	16.804	0.019	2666.667	-1666.667	276.090	137
CDC	0.253	0.000	0.985	0.000	0.388	137

The statistics for UCC (the MTB ratio) are particularly revealing. The mean of 16.80 is vastly higher than the median of 0.019, and the standard deviation is enormous (276.09). This indicates an extremely right-skewed distribution with the presence of extreme outliers. This suggests that while most firms have MTB ratios close to or below 1, a few firms have exceptionally high ratios, potentially due to massive unrecognized intangible assets (like brand value or customer relationships) or very aggressive write-downs of their asset base.

This high variation is ideal for examining the relationship between UCC and tax avoidance.

4.2. Stationarity and Cointegration Results

The ADF unit root tests confirmed that the variables were a mixture of I(0) and I(1), satisfying the pre-condition for the ARDL bounds test. The results of the bounds test are presented in Table 2.

Table 2: ARDL Bounds Test for Cointegration

Model	Dependent Variable	F-Statistic	1% I(0)	1% I(1)	5% I(0)	5% I(1)	Result
1	Cash ETR	5.721	4.29	5.61	3.23	4.35	Cointegration*
2	H&S	6.234	4.29	5.61	3.23	4.35	Cointegration*

Note: * denotes significance at the 1% level.

The computed F-statistics for both models (5.721 and 6.234) exceed the upper critical bounds at the 1% significance level. This leads to the decisive rejection of the null hypothesis of no level relationship. We conclude that a stable, long-run cointegrating relationship exists among unconditional conservatism, conditional conservatism, and both measures of tax avoidance.

4.3. Long-Run Estimation Results

The long-run coefficients derived from the ARDL models are presented in Table 3.

Table 3: Long-Run Coefficients from ARDL Model

Variable	Model 1: Dependent = Cash ETR	Model 2: Dependent = H&S
	Coefficient (p-value)	Coefficient (p-value)
Constant	0.3103 (0.004)**	2.41e+07 (0.028)**
UCC	-0.0041 (0.019)**	3.17e+05 (0.001)*
CDC	-0.2199 (0.029)**	8.92e+06 (0.042)**

Note: *, ** denote significance at the 1% and 5% levels, respectively.

The findings in Table 3 provide strong and detailed evidence on the hypotheses that have been made in this research paper.

In Model 1, the coefficient of unconditional conservatism (UCC) is equal to -0.0041 and it is significant at the 5 % level, thus supporting hypothesis H 1. This finding implies that the relationship between UCC and Cash Effective Tax Rate (ETR) is statistically significant and negative in the long run. The higher the Market-to-Book (MTB) ratio, which indicates higher

UCC, the lower is the Cash ETR, which is a direct impact of the taxation hypothesis: the use of low-income accounting technique decreases the current cash tax burden of the firm.

The coefficient of UCC in Model 2 is positive and significant (3.17×10^{-5} , p less than 0.01) which supports the hypothesis H 2. This finding indicates that there is a substantial positive long-run correlation between UCC and Henry-and-Sansing (H&S) measure. Though the higher H&S value suggests less tax avoidance (negative to zero), the positive coefficient is not inconsistent when one takes into consideration the mechanism behind the matter: UCC systematically reduces the book income by expensing it faster. The H&S measure uses book income in the denominator in the computation of expected tax, therefore, aggressive conservatism creates a large, long-run book-tax gap whereby book income is reduced against the economic tax base, and an H&S value of less negative, or even positive, is obtained. This result underscores the fact that the main tax impact of UCC is not the establishment of an abnormal avoidance, but rather the establishment of a method-based, predictable avoidance by systematic understatement of the reported financial reporting base. The terms of the error-correction-model (ECM) of both specifications are negative and statistically significant, which proves the presence of a stable equilibrium relationship.

4.4 Discussion of Findings

The empirical findings have strong evidence to prove that unconditional accounting conservatism is a major determinant of corporate tax avoidance among the insurance firms in Nigeria, although the manifestations of the same vary to a certain degree across the measures. The negative coefficient on the Cash ETR indicates that companies with more conservative policies pay comparatively less in cash tax as compared to their reported earnings, which coincides with the eventual aim of tax strategy that is, cash conservation.

The positive coefficient on the H&S measure explains the mechanism behind it. UCC works by causing a significant and plausible disjunction between book and tax bases: quick asset impairments and recognizing expenses result in lower reported earnings, which in turn, decreases the denominator of the Cash ETR calculation and directly decreases the ratio. Under the H&S measure, the identical action decreases the expected tax (pre-tax income \times statutory rate) making the effective tax rate of the firm to be nearer to the expected tax rate and therefore giving a higher H&S value.

Such a twofold finding is a good example of taxation hypothesis in Positive Accounting Theory. The Nigerian insurance managers seem to choose UCC not just due to prudential motives but as a tool of tax planning that is tactical and planned. The method is a low-risk type of tax-avoidance, often latent in the accepted accounting conventions and not in obscure transactions, that allows companies to defer taxes, smooth their earnings by releasing hidden reserves and present a more stable fiscal image to regulators and investors as well as to maximize their tax liability.

The results also align with conflicting findings in the literature at large. Current studies which solely use BTD-based measures like the H&S index are likely to misunderstand the influence of UCC, unlike the measures that rely on Cash ETR which can measure the net positive impact of UCC. The simultaneous use of both metrics provides a better and more accurate insight.

5. Conclusion and Implications.

5.1 Summary of Findings

The research question of this study was: Which is the long-run relationship between accounting conservatism that is not conditional and corporate tax avoidance in Nigerian insurance companies during the period 2010-2023? The analysis clearly confirms that UCC, which is represented by the ratio of the MTB, is a major cause of tax avoidance. It has a strong negative correlation with the Cash ETR and a strong positive correlation with the Henry and Sansing measure thus shedding light on the outcome of the strategy as well as on the accounting mechanism.

5.2 Theoretical and Practical Implications.

The implication is far reaching. First, the empirical research supports the taxation hypothesis of Positive Accounting Theory, and it is shown that the introduction of UCC is a rational, incentive-based reaction to the goal of minimizing taxes, especially in an industry with earnings-smoothing, capital management central to it.

In addition, the FIRS needs to acknowledge that low Cash ETR in itself might not be an indication of aggressive tax sheltering but can be attributed to allowable conservative accounting policies. However, the systematic application of such policies to tax deferral is a major and legally allowable cut of present revenue. Firms that have continued to record high levels of MTB ratios and extremely low Cash ETR might have to come under scrutiny by tax authorities.

Furthermore, to managers of insurance firms, the paper highlights practical tax incentives obtained through the implementation of UCC. This approach is justifiable and viable to tax planning and earnings management. Tax implications are also being advised to be taken into account formally by boards and audit committees in endorsing accounting policy options.

Implication on Insurance Regulators (NAICOM). NAICOM will be forced to accept the trade-off involved in UCC. Although it encourages prudence and protection of policyholders by ensuring that they do not understate liabilities, it also discourages stated capital (book value of equity). Regulators that use solvency ratios based on the book-value ought to be cautious because a company can be financially sound than the balance sheet indicates.

5.3 Limitations and Future Research direction.

The research has shortcomings, as it is based on one industry and a country. Future studies may repeat the analysis in other highly regulated industries, including banking, or in a series of emerging economies in order to increase the generalizability. Also, qualitative research that will be conducted through interviews with CFOs and tax directors might provide more insight into the managerial factors that lead to the adoption of UCC.

To sum up, this article confirms that unconditional accounting conservatism is not an act of passive reporting convention but an act of active, intentional corporate tax avoidance in the Nigerian insurance market. Through its exploration of the regulatory prudence, earnings stability

and tax efficiency, UCC highlights the deep, deliberate connection between accounting method choice and corporate fiscal strategy.

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