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Determinants of Accurate Financial Statements Reporting In Listed Banks In Kenya; A Survey Of Commercial Banks In Nakuru Town

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Abstract: *This study examined the factors affecting the accuracy of financial reports in listed banks in Kenya. The theoretical review of the study examined the concept of financial reports, financial reporting and financial reporting quality. The theoretical framework of the study was based on the positive accounting theory, agency theory, stakeholder's theory and signaling theory. The study was based on a descriptive research design. A sample size of 164 respondents was involved in the study. Questionnaires were used to collect data and analyzed using SPSS version 21.The users' knowledge of computerized software was found to affect the quality of the financial reports generated and was the most significant metric in the way computerized accounting affecting financial statement accuracy. The staff professional exposure and bank's internal training also significantly affected the financial reporting accuracy. The study recommended that commercial banks should put an emphasis on training of the finance staff on the usage of the computerized accounting softwares through seminars, training, conference and peer reviews. The study also recommended strengthening of the internal audit committee to be able to check on the top management especially in the context of increasing bank leadership with considerable shareholding in the banks.*
Key words: *Accuracy, Audit Committee, Banking Industry, Computerized Accounting, Financial Report, Financial Reports Quality, Staff Competency, Staff Motivation*

I. Introduction

The financial reporting in an organization includes financial statements as well as any other relevant financial reports. According to Muinde (2013) financial statements are an important part of financial reporting but financial reporting is broader as it includes other financial and non-financial information such as financial highlights, back log data, production data and narrative analyses.

Across the world, cases of inaccurate financial statement reporting have been witnessed with a view of hiding the financial loss the company is making and maintaining share prices in the stock exchange (Muinde, 2013). The most highly published case of the financial statement manipulation involved the Enron Company in the United States (Roman, 2010). The Enron Corporation formed in 1985 through the merger of Houston Natural Gas and Intermonth. While the company's core business was in the supply of gas and maintenance of gas pipeline network, the company diversified into other areas in order to leverage on its experience and take advantage of the changing regulation framework in the energy sector (Sugut, 2014). The diversification strategy enabled the company to deal with the unregulated energy trading markets where it worked to guarantee agreed future prices for the commodities in the energy sector for future delivery. The strategy worked for a while enabling Enron to report 138.7 billion United States dollars in revenue in three quarter trading year results for 2001 hence being ranked among the sixth position in the fortune global 500 (Mutai, 2014).

However, the diversification strategy started having challenges as the company had moved from its core business into areas that it could not competitively position itself in a sustainable manner (Mwaniki, 2013). To enhance its creditworthiness and reputation in the energy futures market, Enron senior management manipulated the accounting records to make it look like they made a lot more money than they actually did. The financial statements hid the borrowings made to sustain the energy futures business that was making less money than it was consuming (Barako, Hancock, &Izan, 2013). The company further hid the a total of 600 million United States Dollars debt that it had accrued upon its partnership with the Chewco and Joint Energy Development Investments from its consolidated financial statements. Among the strategies adopted by the company to hide the debts from its balance sheets was to offer futures transactions equivalent to the debt amounts and later buying them within the year by paying a small percentage of interest (Shuttleworth, 2014). The financial inaccuracies were necessary for the company to maintain its credit rating with the credit agencies and to stabilize its share price in the stock exchange. The financial reporting inaccuracies were noted during the merger talks with Dynegy Company (Matundura, 2014). A major credit rating agency lowered the credit rating of the company forcing a need for immediate payment of the hidden debts. Since the company was not in a financial position to pay off the debts, it was forced to declare bankruptcy (Roman, 2010).

In Kenya, the most high profile case of financial statements inaccuracies was that of the CMC motors. The CMC motors management and board of directors planned to fleece the company through have secret offshore accounts in which they wired money (Matundura, 2014). The CMC motors challenges in its financial statement only became known after change of the management. The Capital Markets Authority accused Deloitte of abetting financial statements inaccuracies. The authority made a formal complaint to the Institute of Certified Public Accountants of Kenya (ICPAK). Deloitte was accused of not recognizing losses from CMC's assets that are damaged, failure to disclose in the annual reports the auto firm's subsidiary in South Sudan, abetting the booking of undelivered vehicle sales as revenues and not capturing interest payments for cars sold on credit (Mwaniki, 2013). These practices were in contrast to the accounting standards of the country as laid down by the institutional accounting framework.

Accurate financial reports play a critical role in the financial management of firms. Financial management refers to the area of business management devoted to the judicious use of capital and a careful selection of sources of capital with a view of enabling the organization to achieve its goals (Sugut, 2014). On the other hand, Mwaniki (2013) defines financial management as managerial activities that concern the acquisition of financial resources and assurances of their effective and efficient use. In this context, financial management involves planning for the future of the business to ensure positive cash flow, organization and directing of the financial resources such as procurement and the utilization of the company's funds (Matundura, 2014; Mwaniki, 2013). Accurate financial reports enables prudent financial management decisions such as investment decision, working capital management, capital structure decisions , dividend decisions and capital budgeting decision. The investment decision refers to the ability and process planning and managing a firm' long-term investments while capital budgeting is used to evaluate whether investments in fixed assets are worth purchasing (Oluoch, 2014). The working capital management involves the management of the short-term assets and liabilities of a company that ensures that a firm has sufficient cash flow to meet its short-term debts and operating expenses (Barako et al., 2013). On the other hand, the capital structure is concerned in the way that the company finances its assets while the dividend decision involves decision on the net profit distribution (Muinde, 2013).

1.1.1 Banking Industry in Kenya

The origins and initial development of the Kenyan banking sector is intertwined with the colonial masters' interest in the wider East Africa's coastline. In this context, the first commercial bank in Kenya was the National Bank of India (NBI) established at No.10 Portuguese street in Zanzibar whose territory extended to modern day Kenya's coastal strip (Alloyo, 2013). The bank was established to cater for the British commercial interests in the wider East Africa region. NBI was to later expand its operations through new branches in Mombasa (1896), Treasury Square Mombasa (1900) and Nairobi (1904)(Gichimu, 2013). Other early development in commercial banks in Kenya included establishment of Post Office Savings Bank (1910), Standard Bank of South Africa (1911), National Bank of South Africa (1916), and merger of National Bank of South Africa with Anglo Egyptian bank to form Barclays Bank Dominion, Colonial and Overseas in 1925(Kimasar, 2014). Others included General Bank of the Netherlands (1951), Bank of Baroda (1953), Habib Bank (1956), Ottoman bank (1958) and Commercial Bank of Kenya (1958) (Kimasar, 2014).According to Central Bank of Kenya (2014), the banking sector in Kenya is comprised of the Central Bank of Kenya, as the regulatory authority, 44 banking institutions (43 commercial banks and 1 mortgage finance company - MFC), 7 representative offices of foreign banks, 9 Microfinance Banks (MFBs), 2 credit reference bureaus (CRBs) and 101 forex bureaus. Despite this the commercial banks have been having a challenge of providing accurate financial statements.

1.2 Statement of the Problem

The global credit crises raised several fundamental issues on the financial reporting due to the high number of the failed financial institutions. Amongst the major concerns was the ability of the financial statements to warn users of the risks of failure even when the statements were prepared on the current financial reporting frameworks. It also appeared that the financial information prepared did not ward the users on the extent to which the institutions were vulnerable even when the information supplied complied with the applicable accounting guidance. Locally, there was controversy on the misinformation contained in the CMC motors financial statements despite the same being audited by a reputable auditing firm. The ability of the CMC directors and board members being able to siphon millions of shillings for years without detection by the auditors and the shareholders raised the questions on the integrity of the financial statements. These are cases of the integrity of the financial statements not being in a position to reflect the financial strength and weaknesses of the business hence failing on its core mandates. This study sought to examine the fundamental question on what determines the financial statements reporting accuracy. The study has focused on the commercial banks in Kenya due to the high competition in the industry and hence vulnerability to financial statements incorrect reporting.

1.3 Research Objectives

i) To find out the extent to which the use of computerized accounting affects the accuracy of financial reporting
ii) To examine the influence of staff competence on the accuracy of financial reporting

II. Literature Review

2.1 Theoretical Framework

The theoretical framework was based on four theories namely the positive accounting theory, agency theory, stakeholder's theory and signaling theory.

2.1.1 Positive Accounting Theory (PAT)

Watts and Zimmerman developed the PAT in 1978 and 1986 with a view of seeking to predict and explain why managers have a preference for given accounting methods (Sugut, 2014). The PAT explains why accounting is what it is, why accountants do what they do and what effect these phenomena have on people and resources utilization (Mutai, 2014). Abdulrazak (2013) argues that PAT is the reason for the choice of accounting methods, techniques and policy decisions. The organization is described by PAT in the form of collection of contracts that are necessary to help self-seeking individuals agree to cooperate such as employee contracts and supplier contracts etc. (Mutai, 2014). These contracts have associated contract costs such as monitoring and evaluation costs, negotiation costs and agency costs. PAT holds that firms seek to minimize the contracting costs that in turn affect the accounting policies adopted.

According to PAT, the information in the financial reports can be distorted based on the management motive in several ways (Oluoch, 2014). The management has information advantage over the owners of the business and may seek to influence the reporting of earning and capital structure in financial reports due to conflict of interest between the managers (agents) and owners of firm (principals). The PAT thus seeks to explain the manager's choice of accounting methods in terms of self-interest and relationship between stakeholders. In doing this, PAT has advanced three theories that seek to explain these phenomena; bonus hypothesis, contractual motivation hypothesis and political motivation hypothesis (Abdulrazak, 2013; Mutai, 2014; Oluoch, 2014). The PAT theory was considered relevant to this study as it will explain the incentives of financial statements manipulation among the top management such as the performance bonus being linked to the profitability of the bank.

2.1.2 Agency Theory

Meckling and Jensen developed the agency theory in 1976 to explain the relationship between principals (shareholders) and agents (managers)(Mwaniki, 2013). In this context, the principal delegates an agent to perform work in the best interest of the principal (Oluoch, 2014). However, this delegation of the decision-making authority can lead to a loss of efficiency and consequently increased costs (Mwaniki, 2013). In the context of the financial reporting accuracy, the agency theory is concerned with the corporate disclosures that provide an enabling environment for the managers to disclose negative information voluntarily. This corporate disclosure is critical in the context that there is conflict of interest between managers and shareholders and conflicts between the firm and its creditors (Oluoch, 2014). The firms make disclosures through regulated financial reports including financial statements, footnotes, management discussion and analysis, and other regulatory filings (Barako et al., 2013). However, these corporate disclosures are affected by several factors, which compromise the quality of financial reporting. The corporate disclosures are shaped by the manager's reporting and disclosure, mandated reporting and disclosures regulations, and analyst's expectations (Oluoch, 2014). The agency theory is important to this study as it has explained the role of discretionary financial statement declarations and how they may influence the financial statements accuracy.

2.1.3 Stakeholder's Theory

The stakeholder's theory is based on the notion that the organization's effectiveness is measured by its ability to satisfy both the agents and shareholders who have a stake on the organization (Matundura, 2014). However, the agents in a firm who are the managers of the firms are expected to serve and meet the demands of the shareholders who are the owners of the firms (Oluoch, 2014). The shareholder's theory thus seeks to explain the structure and operations of established corporations in preparing accounting information to meet the needs of the shareholders (Abdulrazak, 2013). The shareholders thus seeks to explain the corporate disclosures, explore more on the pattern of information disclosure, qualitative characteristics of the information disclosed, and the behavior of the top executives in the provision of the timely information (Kamwenji, 2014). The top executives of a firm make choices or decisions that affect the accounting system of the company by influencing the shareholders or contractual outcomes (Matundura, 2014).

2.1.4 Signaling Theory

The signaling theory is used to describe the behaviour of two parties with access to different information. In this context, one party (the sender) must choose whether and how to communicate (or signal) that information and the other party (the receiver) must choose how to interpret the signal (Kamwenji, 2014). Companies with superior performance may use financial reporting to signal to the market while adoption of international accounting standards may signal the company's good management (Oluoch, 2014). The theory is applicable in the context that bank's top management may be tempted to manipulate financial statement in order to project a positive image of the company.

2.2 Conceptual Review

The conceptual framework is based on two objectives of the study.

2.2.1 Effect of the Use of Technology on Financial Reporting

Computerized accounting system is the application of the computer-based software used to input, process, store, and output accounting information (Muinde, 2013). This application is in support of the ever advancing technology that enables firms to use computer programs to perform tasks that were previously done manually (Sugut, 2014). A computerized accounting system therefore involves the computerization of accounting information systems that is established in order to facilitate decision making. These are associated with a numbers of benefits like speed of carrying out routine transactions, timeliness, quick analysis, accuracy and reporting (Muinde, 2013).

According to Matundura (2014), an accounting system consists of business papers, records, reports and procedures that are used by an organization in recording transactions and reporting their effects. Mutai (2014)underlines that an accounting system is a way of keeping a written record of transactions .Receipts are given for all money that is received by an organization and receipts are asked for every time money is spent. According to Oluoch (2014), an accounting system, regardless of the size of the organization, is designed to collect, process and report periodic financial information about the entity. Several tools can be derived from computerized accounting systems top indicate financial reporting. Familiar tools are annual reports, financial accounts, performance assessments, quarterly reports, independent evaluations and audits. Muinde (2013)stresses that the heart of fiscal management in any organization is a good accounting system that is appropriate to that organization.organization. In order to achieve consistent financial accountability it is necessary to establish standards and a system for accounting practices. Shuttleworth (2014), state that in order to determine the effectiveness of a financial reporting system, one must understand its objectives.

2.2.2 Influence of Staff Competence on Financial Reporting

The Institute of Certified Public Accountants of Kenya (ICPAK) was established in 1977 but as at the end of 1999, only 6,000 students out of 18,000 that had passed CPA examinations has become members (Sugut, 2014). This implies that accountants who have passed exams, but have not registered with ICPAK, are not receiving appropriate Continuous Professional Education and the guidance required to conduct the functions of accounting thereby, diluting the quality of accounting(Mutai, 2014). Kenya has adopted the International Financial Reporting Standards (IFRS) that should the country enhance on its reporting standards. IFRS is a critical component of the accounting quality process as it forms the basis of professional practice in any country. In spite of this, slightly over ten years since IFRS was adopted in Kenya, the Accountants Act has not been explicit on ICPAK issuing IFRS. This has led to a situation where there is no legal basis upon which reinforcement can be effected by ICPAK, the other Act relevant to accounting in Kenya is the Companies Act known as cap 486 which was modelled alongside the UK Companies Act of 1948(Barako et al., 2013).

2.3 Accurate Financial Reporting

Accurate financial reporting refers to the ability of the financial reports to portray the true financial position of the company in terms of profitability, assets, bad debts provisions and other measures (Abdulrazak, 2013). The statements need to give third parties looking at the information such as regulators and the potential investors the worth and strength of the company. The financial statements that should also be checked by independent auditors also need to show the weaknesses of the company to enable prudent decision-making (Barako et al., 2013). The accurate financial reporting is important due to several factors. The accurate financial reports form the basis for the valuation of the company and analyzing the operational results. It is easier to market the company to potential investors when there are financial reports that are sound and have integrity (Barako et al., 2013).

III. Methodology

3.1 Research Design

This study was based on a descriptive survey design. The design was used in the study since the researcher was interested in establishing the factors that influence the financial reporting in commercial banks in Kenya. The study did not involve manipulation of the sample but sought to study the sample in their natural setting.

3.2 Target Population

The target population of this study was the commercial banks within Nakuru Sub County where the research was based. 25 commercial banks in Nakuru Sub County with over 800 bank staff, which 280 staff middle and senior management levels were involved in the study. The listed commercial banks were Equity Bank, KCB, Cooperative Bank, Standard Chartered Bank, and Barclays Bank. The others were CFC Stanbic Bank, Diamond Trust Bank, I&M Bank, NIC Bank, National Bank of Kenya and Housing Finance.

3.3 Sampling Size and Sampling Technique

The sample size of this study was determined through the Yaro Yamane's 1967 simplified formula as illustrated by Fekadu (2009):

$$n = \frac{N}{1+N(e^2)}$$

where n= sample size
N=Population size = 280
e= tolerable error (5%)

Therefore: $$n = \frac{280}{1+280(0.05^2)} = 164 \text{ respondents}$$

164 respondents were involved in the study. However, since the market share of the listed banks was estimated to be 69.87% as indicated by CBK statistics then the sample size for the study was adjusted to 115 respondents. Stratified random sampling technique was used in the sample selection.

3.4 Research Instrument

The questionnaire was used as the data collection tool due to cost efficiency and ease of data analysis as the questions were uniform. The questionnaire also eliminated the interviewer bias and helped to generate quality responses as the respondents had time to go through the questionnaires (Abdul-jabbar & Pope, 2008; Mwithiga, 2010).

3.5 Data Processing and Analysis

The data was collected and analyzed using both quantitative and qualitative methods. Quantitative method involved both descriptive and inferential analysis. Descriptive analysis such as frequencies and percentages was used to present quantitative data in form of tables and graphs. Data from questionnaire were then analyzed using Statistical Package for Social Science Version 21. Descriptive statistics involved the use of absolute and relative frequencies.

IV. Results

4.1Financial Reporting Accuracy

Table 1 shows the responses on different financial reporting metrics.

Table 1: Frequency Distributions of Various Financial Reporting Metrics

Statement	SA	A	U	D	SD	TOTAL
Valid arguments are advanced to support decisions for certain assumptions and estimates in the financial reports	15.8%	27.4%	48.4%	8.4%	0%	100%
The bank uses relevant and accurate non-financial information to complement the financial information	6.3%	17.9%	46.3%	16.8%	12.6%	100%
The process of accurate financial reporting is enhanced through internal audit mechanism	15.8%	57.9%	26.3%	0.0%	0.0%	100%
There exists specific guidelines on accurate financial reporting	15.8%	27.4%	35.8%	21.1%	1.0%	100%

When asked whether the bank used valid arguments to support assumptions and estimates in financial reports, a cumulative percentage of 43.2% indicated strongly agree and agree. This figure is slightly less than 48.4% of the respondents who indicated they were uncertain. This indicates this metric could be a significant determinant of the financial reporting accuracy going by the high number of the respondents that were uncertain. Similarly, in the context of the bank's use of relevant and accurate non-financial information to complement financial information, 6.3% indicated strongly agree and 17.9% indicated agree. This is a cumulative percentage of 24.2% compared to 46.3% of the respondents who were uncertain. The high number of the respondents who were uncertain could imply that this could be a major determinant of the financial report accuracy. In context to the use of the internal audit functions to enhance financial reporting accuracy, a majority of the respondents (57.9%) indicated agreement while 15.8% indicated strongly agree making a cumulative percentage of 73.7% of the respondents in support of the indicator. Finally, in relation to the existence of the specific guidelines for accurate financial reporting, 15.8% indicated strongly agree, 27.4% agree, 35.8% uncertain, 21.1% disagree and 1% strongly disagreed.

4.2 Influence of Computerized Accounting on Financial Reporting Accuracy

Table 2 presents the descriptive statistics on the impact of computerized accounting on financial statement accuracy.

Table 2: Distribution Frequencies for Computerized Accounting

Statement	SA	A	U	D	SD	Total
The bank's accounting systems are fully computerized	43.2%	40.0%	16.8%	0%	0%	100%
The users' knowledge on computerized software affects the quality of the financial reports generated	26.3%	54.7%	18.9%	0%	0%	100%
The users' experience on the use of the computerized software affects the quality of the financial reports generated	32.6%	49.5%	17.9%	0%	0%	100%
The users' level of training on the use of the computerized software affects the quality of the financial reports generated	35.8%	54.7%	9.5%	0%	0%	100%
The quality of the information fed on the computerized accounting system affects the quality of the financial reports generated	46.3%	35.8%	17.9%	0%	0%	100%

In this context, a majority of the respondents (83.2%) indicated that they agreed that all the banking systems had been computerized. Only 16.8% of the respondents were uncertain on whether the whole banking accounting processes had been computerized. The high number of respondents who were affirmative that all the bank's accounting systems had been computerized can be attributed to the fact that accounting softwares were easily available. In the context of whether the user's knowledge on computerized software affected the quality of financial statements, 26.3% indicated strongly agree, 54.7% agreed, while 18.9% were uncertain.

Therefore, a cumulative figure of 81.1% of the respondents was affirmative that the user's knowledge on the accounting software played a critical role in the quality of the financial reports generated. In the context of the users' experience on the use of computerized accounting, only 17.9% of the respondents were uncertain on the metric. In relations to the users' level of training on the use of computerized software on the impact of the financial reports generated, 35.8% indicated strongly agree, 54.7% indicated agree while 9.5% were uncertain. When asked on the impact of the quality of information fed on computerized accounting system on the financial reports, 46.3% of the respondents' indicated strongly agree, 35.8% agree, and 17.9% were uncertain.

4.3 Influence of Staff Competence on Financial Statement Accuracy

Table 3 shows the distribution frequencies of the influence of the staff competence on the financial statement accuracy.

Table 3: Distribution Frequencies on Staff Competence Influence on FA

Statement	SA	A	U	D	SD	TOTAL
The accuracy of the bank's financial reports is dependent on the staff formal education qualifications	15.8%	28.4%	38.9%	8.4%	8.4%	100%
The accuracy of the bank's financial reports is dependent on the staff professional experience	42.1%	30.5%	18.9%	8.4%	0%	100%
The accuracy of the bank's financial reports is dependent on the staff professional exposure	35.8%	33.7%	17.9%	12.6%	0%	100%
The accuracy of the bank's financial reports is dependent on the bank's internal trainings on accurate financial reports	27.4%	60.0%	12.6%	0%	0%	100%
The accuracy of the bank's financial reports is dependent on staff knowledge of accounting standards	34.7%	33.7%	22.1%	9.5%	0%	100%

In the context of the influence of the staff formal education on financial statement, 15.8% strong agree , 28.4% indicated agree, 38.9% indicated uncertain, 8.4% disagree and 8.4% strong disagreed. On the other hand, the staff professional experience influence on financial statement accuracy had 42.1% and 30.5% of the respondents indicating strongly agree and agree respectively. This showed that a cumulative percentage of 72.6 % of the respondents answered in the affirmative. The professional exposure was cited by 35.85% (strongly agree), 33.7% (agree), 17.9% (uncertain), and disagree (12.6%) as an item that influenced the financial statement accuracy. The internal training on accurate financial reports was cited by 27.4% (strongly agree), 60.0% (agree), and uncertain (12.6%) as an influencing factor on financial statement accuracy. On the other hand, the staff knowledge of accounting standards was cited by 34.7% (strongly agree), 33.7% (agree), 22.1% (uncertain), and 9.5% (disagree).

4.4 Inferential Statistics

The examination of the influence of computerized accounting and staff competence on the financial statement accuracy was done using multiple regression analysis as shown in Table 4.

Table 4. Model Summary for Multiple Analyses

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.621[a]	.386	.419	.53168
a. Predictors: (Constant); staff Competence ; Computerized Accounting				

The model summary provides the R and R^2 values. The R^2 value of 0.386 indicates how much of the variations in dependent variable, was explained by the independent variables, Staff competence and computerized Accounting. In this case, 38.6% was explained by staff competence and computerized accounting while the remaining 61.4% was explained by the other variables of the study. Table 5 gives the coefficients of the regression analysis (beta values) as -0.317, 1.431, 0.177 and 0.513 for a constant, computerized accounting, top management and staff competence respectively.

Table 5: The Coefficients of the Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-0.317	.243		-1.302	.196
	Computerized Accounting	1.431	.276	.421	5.190	.000
	Staff Competence	.513	.119	.384	4.305	.000
a. Dependent Variable: Accuracy						

As shown in table, the combined regression analysis was:
Y= 1.431 (Computerized accounting) + 0.513 (Staff competence)-0.317+ error

V. Conculsions And Recommedations

5.1 Conclusions

The users' knowledge on computerized software affected the quality of financial reports generated was the most significant metric in the way computerized accounting affected financial statement accuracy. This was followed by the users' level of training on the use of the computerized software affects the quality of the financial reports generated. The staff professional exposure and bank's internal training significantly affected the financial reporting accuracy as they had loading of 0.937 and 0.934 respectively.

5.2 Recommendations

The bank should put an emphasis on the training of the finance staff more on the usage of the computerized accounting softwares through seminars, training, conference and peer reviews. The study recommends increased staff professional exposure through seminars and conferences to enhance the staff competence on financial stament's accuracy.

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