THE RELATIONSHIP BETWEEN REPORTING QUALITY AND FINANCIAL PERFORMANCE OF COMPANIES LISTED AT NAIROBI SECURITIES EXCHANGE

BY

VIVIAN OUMA

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DECLARATION

This project is my original work and has not been presented for a degree in any other university

Sign: ……………………………………….. Date………………………

Vivian Ouma

D63/82404/2015

This research project has been submitted for examination with my approval as the university supervisor

Sign: …………………………………….….. Date: ………………………….

Dr Herrick Ondigo, PHD.

Lecturer, Department of Finance and Accounting

School of Business, University of Nairobi

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DEDICATION

I dedicate this project to Almighty God who has been my strength and wisdom. To my family, for your love and encouragement

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LIST OF ABBREVIATIONS

FASB; Financial Accounting Standards Board

GAAP; Generally Accepted Accounting Principles.

IAS; International Accounting Standards.

IASB; International Accounting Standards Board

IASC; International Accounting Standards Committee.

ICPAK; Institute of Certified Public Accountants of Kenya

IFRS; International Financial Reporting Standards

NSE; Nairobi Securities Exchange

SME; Small and Medium Enterprises

ABSTRACT

The quality of financial reporting is assessed in terms of the underlying fundamental qualitative characteristics which include relevance and faithful representation and the enhancing qualitative characteristics which are understandability, comparability, verifiability and timeliness as defined in 'An improved Conceptual Framework for Financial Reporting' of the FASB and the IASB (2008).

The provision of high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making is the primary objective of financial reporting. Compliance with financial reporting quality leads to improved financial performance in terms of liquidity ratios, solvency ratios, liquidity ratios as well as efficiency ratios. This will enable capital providers and other investors in making investment, credit and other important decisions enhancing overall market efficiency.

CHAPTER ONE
INTRODUCTION

1 .1 Background of the Study

The Standards were introduced by the registered Institute of Certified Institute of Certified Public Accountants of Kenya in 1998. This standard was to be operational for all financial statements periods beginning 1st January 1999. Kenya national accounting standard includes both the fill IFRS and the IFRS for SMEs. Different governmental regulatory bodies such as Central Bank of Kenya issues regulations that have incorporated the requirements on how to use International Financial Reporting Standards. Other institutions issuing similar regulations includes; Insurance regulatory Authority of Kenya (IRA), Retirement Benefits Authority and Capital Market Authority. Moreover these accounting standards are used by NSE on publication of company's rules (Hotl et al 2011).

International Accounting Standards Boards (IASB) established in 2001 is a publishing body for the International Financial Reporting Standards (IFRS). The agreement was given after realization of expected benefits arising from change to IFRS from GAAP of the financial reporting quality improvement being the core motive of IFRS. Proponents of adopting IFRS posits as the quality and understanding of accounting information is improved (Schipper, 2005; Whittington, 2005).

According to Mutai (2014), the IFRS adoption of companies listed in Nairobi Stock Exchange assisted at reducing barriers to trading across borders of securities by ensuring that the company accounts are easily reliable, transparent, and comparable. Therefore the company reduces the cost of raising capital and also enhances the growth and become more competitive. Although, the response to IFRS globally and locally has been commendable it is faced by myriad of challenges mostly for small and medium enterprises where the administrative and cot of preparing and auditing individual company accounts increases. IFRS also requires listed companies to disclose their financial reports which are causing a disadvantage as compared to companies that do not follow strict rules competitively.

The IFRS adoption in Kenya is in phases. Between 1973 & 2000 International Accounting Standards Committee introduced 41 accounting standards. At the end of the period IASC was replaced by International Accounting Standards Board (IASB). The new board was aimed at enhancing and filtering the accounting standards for a period of 8 years starting from 2000 to 2008 there was a significant reduction of the accounting standards from 41 standards to 28 by end of 2008. Primarily these standards are geared towards providing reliable, relevant and timely for corporation investors and creditors in accordance to the IASB's accounting framework. It is a mandatory requirement for companies listed in Kenya to be IFRS compliant. Other than listed companies there is a set of other specific IFRS designed for Small and Medium Enterprises. These development coupled by lack of the literature regarding the effects of IFRS, having been made mandatory for use in reporting by the listed companies, this study aims to establish whether there is evidence to suggest improvement in quality of financial reports.

1.1.1 Financial Reporting Quality

The quality of financial reporting is assessed in terms of the underlying fundamental qualitative characteristics which include relevance and faithful representation and the enhancing qualitative characteristics which are understandability, comparability, verifiability and timeliness as defined in 'An improved Conceptual Framework for Financial Reporting' of the FASB and the IASB (2008).

Relevance: is referred to as the capability "of making a difference in the decisions made by users in their capacity as capital providers" (IASB, 2008: 35).

Faithful representation: To faithfully represent economic phenomena that information purports to represent, annual reports must be complete, neutral, and free from material error (IASB, 2008: 36). Economic phenomena represented in the annual report are "economic resources and obligations and the transactions and other events and circumstances that change them" (IASB, 2006: 48). Faithful representation is measured while referring neutrality, completeness, freedom from material error, and verifiability.

Understandability: Will increase when information is classified, characterized, and presented clearly and concisely. Understandability is referred to, when the quality of information enables users to comprehend their meaning (IASB, 2008). Understandability is measured using items that emphasize the transparency and clearness of the information presented in annual reports.

Comparability: Is the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena" (IASB, 2008: 39). Similar situations should be presented the same, while different situations should be presented differently while focussing on consistency.

Timeliness: It means having information available to decision makers before it loses its capacity to influence decisions" (IASB, 2008: 40). Timeliness refers to the time it takes to reveal the information and is related to decision usefulness in general (IASB, 2008). When examining the quality of information in annual reports, timeliness is measured using the natural logarithm of amount of days between year end and the signature on the auditors' report after year end is calculated

1.1.2 Financial Performance

A measure of how a firm can use its assets well to generate revenues. Financial performance also measures overall financial health of a firm over a given period of time which can then be used in comparing with similar firms.

This will be yardstick on measurement are that quality financial reporting improve performance of an organization based on transparency, reduce cost of preparation, make investment decision efficient, reduce capital cost, enhance comparability, reduce need for supplementary information, expand financial statement disclosure and improve measurement and recognition, understandability, reliability and relevance.

Financial performance can be measured by reviewing financial statements and computing ratios.

There are a number commonly used accounting ratios that provide useful measures of business performance. These Include: liquidity ratios, which tells the ability to meet short-term financial obligations. Efficiency ratios, which tells how well business assets are put into use. Financial leverage or gearing ratios, which tells how sustainable exposure to long-term debt is.

1.1.3 Reporting Quality and Financial Performance

An investigation on effect of quality of financial reporting on financial performance in emerging economies was carried out in China and Hongkong by Nnadi (2013). In the study financial reporting standards was evaluated over a ten year period using earnings management metric approach. The study reported an inverse relationship between financial reporting quality and financial performance. Moreover, there were significant differences on quality of financial reporting reported which signed there are possible differences depending on regions where a company was listed. This calls for examination on the effect of financial reporting quality on financial performance in developing economies and more so Kenya.

An examination on the influence of financial reporting quality and banking quality information was carried out in Nigeria by Onalo, LIzam and Kaseri (2014). Earnings management, timely reporting of losses and valuation approach followed were used as measures of quality financial reporting. An investigation of 20 banks within a six year period revealed that there was a significant marginal influence of financial reporting quality to value relevance, which ultimately reduced possibilities of capital market frauds.

Duarte, Irina and Azevedo (2015) reviewed the nexus between financial performance and financial reporting quality. Through Meta analysis, results of study revealed that financial reporting quality does not only enhance performance but it also minimizes level of information asymmetry. Even though there is need for financial reporting quality it is limited in its relevance since despite addressing institutional related issues it falls short handling both real and economic rationally based issues which cannot be left to accounting principles only.

An Australian study was carried out to investigate the impact of financial reporting quality on financial performance. Although, the study adopted non linearity analysis the findings revealed that financial reporting quality had significant influence on financial performance even though there were measurement errors which were minimal.

Naghshbandi and Ombati (2014) investigated issues, challenges affecting financial reporting quality in Kenya. They argued that their adoption has been inhibited by skill and competence levels in developing economies, perception from developing countries that there are European or politically mitigated, different levels of compliance and regulatory policies, cultural and structural differences and ownership structures of various business enterprises. Although, these challenges may lead to slowness in adoption of IFRS the anticipated benefits in regard to voluntary and mandatory disclosure triggers higher acceptance levels.

A Kenyan perspective on the effect of financial reporting quality on performance was carried out by King'wara (2015). In the study a sample of listed companies from 1994 to 2003 was drawn in exclusion of both banking and insurance companies. A comparative analysis was carried out before and after implementation of IFRS and the findings revealed that financial reporting quality had a significant influence on performance. Despite the findings there was a gap which was not addressed since there was no justification to warrant exclusion of those companies which were listed in the banking and insurance sector.

1.1.4 Nairobi Securities Exchange.

Initially, NSE membership was open to brokers but they were registered under the societies act in 1954 and was incorporated into the Kenya Company's act as a limited company in 1991. Market intermediaries have been in the rise in Kenya. There are 68 listed firms in the NSE whose shares are currently trading. The traded securities include equities, bonds, preferred shares, ordinary shares.

NSE has classified the listed companies to ten sectors; services and commercial, agricultural, banking, technology and telecommunication, insurance, accessories and automobiles, construction and allied, real estate investment trust, investment services, manufacturing and allied, exchange traded fund (NSE, 2017). Share price increase denotes a company's value and shareholders wealth increase Wedinger and Plats (2012). The NSE had a market capitalization of approximately USD 23 billion by the end of 2016.

1.2 Research Problem

Financial statement is prepared for use by many interested parties who include current and potential investors, government authorities, investment banks and stock brokers. Therefore, both listed and non-listed company should endeavour to prepare books of accounts which will be true and fair, more user friendly and can attract a pool of interrelated networks. Through this the level of information asymmetry will be minimized and this kind of quality financial reporting will improve financial performance.

IFRS has been accepted as an international model while preparing books of account for financial reporting quality and it has attracted empirical enquiry both locally and globally though there are mixed and inconsistent results which has been reported so far. This was later refuted by scholars who purported financial reporting quality not to have significant influence on performance. Similar trend was reported in Sweden on non-significance of quality reporting in performance by Paananen (2008). There is anticipated difference depending on economic regulatory even after IFRS adoption. A comparative analysis in the financial reporting quality yielding inconclusive results in positive contribution in financial performance. Moreover, A UK case by Brochet, Jagolinzer and Riedl (2011) revealed that quality financial reporting not only improve financial performance but also enhances networking between key players.

It is also hypothesized that the quality financial reporting in Kenya as compared to KAS given mandatory adoption and KAS framework being similar to IASB's may yield mixed results. In 2009, the Kenya Business Indicator Index (KBII) gave the country a score of 6.48 out of 12 and ranked it at 71 out of 100 countries (Standards Forum 2009). It is clear that Kenya's compliance is quite low. These indices send mixed signals about Kenya's business climate as well as the fact that in spite of the challenges of implementing the standards, many things are on track.

It is imperative to examine effect that financial reporting quality has on financial performance because of methodological issues which has not been persistently addressed by the past studies. Moreover, the inclusion and exclusion of some companies listed in different sectors may have effect on the outcomes. Thirdly, there were changes which were enacted recently in the company's act and could have influence on financial reporting quality. It`s against this backdrop that study seeks to address the following question: is there a relationship between financial reporting quality and performance of listed companies at Nairobi securities exchange?

1.3 Objective of the Study

To establish the relationship between reporting quality and financial performance of companies listed at Nairobi securities exchange**.**

1.4 Value of the Study

Studying quality financial reporting against financial performance at NSE has great value in policy formulation. It has high importance to the companies listed at NSE. This study will be of assistance to the management of capital market Authority on how to use financial reporting quality to improve performance and hence be able to identify problems and opportunities.

This study will be of great contribution to the existing body of financial reporting quality knowledge and generate interests among researchers, academicians and scholars. The study will also form an in depth information for literature review and a reference point in examining different quality financial reporting.

Findings from this should to be used by players in understanding the financial reporting system effectiveness including practitioners as well as new members training or development.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In chapter two, the researcher reviewed other literatures done on Financial Reporting Quality. The literature covers relevant research on the subject. The review of literature reviewed what other researchers have done on the relationship between financial reporting quality and financial performance. Various scholars, authors, international organizations and researchers have developed various perspectives on importance of quality financial reporting. This chapter aimed at reviewing what these institutions and individuals who have developed in terms of aspects and knowledge on the importance of financial reporting quality. This chapter involved the review of the theoretical literature.

2.2 Theoretical Framework

The current study will be based on normative theory, positive accounting theory and events approach theory. In this section the theory will be discussed in both its strengths and weakness and how relevant it will be in the particular study.

2.2.1 Normative Approach Theory

The theorist had been developing accounting principles with a concern on accounting issues such as recognition and measurement. These theorists asked questions including: whether the changes in market prices are to be recognized and how they are to be used in financial statements preparation, Chambers and Ijir (1975). Theories prescribing particular actions are referred to as normative theory. Normative theories of accounting are neither evaluated on their true reflection nor because they are not necessarily based on observation.

The theory will be appropriate for the study since there is need for accounting information to be faith representation of the true status in a specific company.

2.2.2 Positive Accounting Theory

This theory is for explaining and predicting accounting practices that are actual. According to Ball and Brown (1968). Empirical observation forms the basis of positive theories, there are other theories not based not on observation but on what the researcher believes should occur in certain circumstances. Some assumptions underlying normative approach were examined and the claim of meaningless earning numbers was undermined because of the basis used which was multiple valuation computation (Watts and Zimmerman, 1986). The positive accounting can be associated with the view of the firm on a contractual term.

According to Ball and brown (1968), PAT includes accounting research of capital market and accounting choices research. PAT provides importance to research on stock prices, accounting numbers, stock prices, returns as well as determinant of accounting choice and their association, hence representing a major shift in accounting paradigm. The theory is appropriate for the study since the accounting reports must strive to give the relevant information and should be easily understood and opens for any comparative analysis. Moreover, those tasked with preparing the books of account ought to append their signatures on time to minimize possibilities of accounting manipulations.

2.3 Determinants of Financial Performance

The performance explanation varies between firms continues to be of significant importance in the literature, particularly since when the article of Schmalensee (1985) was published. Economists and managers have given a clear primacy to the terms of corporate finance in their interpretative efforts. Also, the main factor affecting the firm performance is the financial structure.

Classically, An entity characterized by contractual relations is the company as analyzed. Its value has been defined by the profit, stakeholder value and ultimately, shareholder value (Gaby and Hirigoyen, 2001). Leland and Pyle (1977) show that the performance of a company is more correlated with the share of capital owned by the shareholding director. Therefore, it is related to the financial structure. This result led to consider, in the financial structure, in addition to debt and equity, the ownership structure in terms of concentration of capital. In addition, the relationship between performance and ownership structure is not clearly stated in the empirical analysis. Some works emphasize the idea of neutrality, while others tend towards that of the non-neutrality. In addition, the study of the relationship between debt and performance, Jensen (1986) considers that the debt should require executives to retain only profitable projects to avoid bankruptcy of the company. Indeed, debt financing would encourage leaders to be more efficient and effective in the positions occupied.

2.4 Empirical Review

An investigation on the determinants of quality of financial statements among listed commercial banks in Nakuru was carried out by Tarus, Muturi and Kwasira (2015). The study was hinged on positive accounting theory, agency theory, stakeholder's theory and signalling hypothesis.
Descriptive research design was adopted and 164 respondents were drawn using simple random sampling from employees working in commercial banks. Results of study revealed significant relationship between computerized accounting, professional development and internal skills development within commercial banks and quality of financial reporting. From the findings it was recommended that there is need for continuous skills development through seminars and workshops. It would have been appropriate for the study to draw a sample from more banks rather than those which are listed.

A study by Beest, Braam and Boelens (2009) investigated the qualitative determinants of quality of financial reporting. The study hypothesised that financial statements must be accurate, verifiable, understandable and timely. The study adopted a 21 research instrument to test for the adherence of these qualities from a sample of listed companies drawn from United States, United Kingdom and Dutch from 2005 to 2007. From the study findings annual financial statements were found to be understandable, comparable, reliable and timely.

An investigation of the quality accounting determinants in European Union on quality financial reporting was carried out by Paiva and Lauranco (2010). In the study it was hypothesised that there were chances of earnings management and other financial performance indicators if the companies adopted quality financial reporting. Panel secondary data retrieved from financial statements of companies listed in period ranging from 2006 to 2008. Multiple regression analysis was fitted on audit quality, a dummy variable on whether a company was audited by big four or not, firm size, disclosure level, earnings level, turnover, growth, cash flows and leverage. A significant and a negative relationship between absolute discretionary accrual and firm size, audit size, disclosure level, cash flows and growth was found. In contrast, a significant and positive relationship between absolute discretionary accrual and leverage, earnings issue and sales turnover was found. It would have been appropriate to adopt panel research design and carry out panel diagnostic test prior to fitting the regression model.

International search on the nexus between corporate financial performance and financial reporting quality was carried out by Ferrero (2014), quality reporting was operationalized as earnings quality, conservatism and accruals quality while corporate performance was market to book ratio. The study adopted panel research design and a sample of 1960 non-financial listed firms in 25 countries in 2002 to 2008 were considered. Regression analysis through Generalised methods Moments (GMM) showed a positive relationship which was significant between financial reporting quality and corporate performance. It would have been appropriate to carry out panel data test such as stationarity, granger causality and Hausman test.

A Ghanaian case on the determinants of quality of financial reporting was carried out by Mensah (2015). The study hypothesed that financial reporting quality was influenced by independent directorship, ownership concentration, firm size, profitability, liquidity and leverage. Cross sectional data was collected from audited annual financial statements for the year 2012. Results of the study revealed that the average voluntary disclosure was 63%. Multiple regression analysis revealed significant relationship between leverage, shareholders concentration, board ownership and independent directorship and quality of financial reporting.

An Asian comparative analysis on the case for and against quality financial reporting and financial performance by Morris, Susilowati and Gray (2012), simple random sampling was used to draw 262 companies which were listed in eight Asian countries. Amongst those selected some countries had adopted quality financial reporting while the rest had not. Secondary data was collected through use of a customised 441 items check list for quality financial reporting. The study was carried out in the periods 2002 to 2007. Results of the study revealed that quality financial reporting improved performance which did not only differ with time but also varied across the countries under investigation. Moreover, disclosure levels adopted by institutions led to improvements in the corporate information asymmetry. An African examination on the determinants of financial performance in Africa was carried out by Owolabi and Iyoha (2012). In the study cross sectional data was collected using a closed ended questionnaire which drew respondents from users and preparers of annual audited financial statements. Purposive sampling was used to select 58 preparers of annual financial statements and 38 users of them. Analysis of data was done using descriptive statistics and on average respondents there were remarkable success since the adoption of quality financial reporting due to monitoring and enforcement of professional standards and quality of prevailing accounting education. Further, it was revealed that there were some benefits on financial performance associated with adoption of quality financial reporting for example improved management, better and quality reporting and budgeting policies, better risk management policy and lower operational costs. Despite of all these the adoption is challenged by constrained budgetary allocations, inadequate levels of training and development, complexity of policies and different culture of organization management. It would have been appropriate to adopt exploratory factors analysis and alternative inferential statistics in addition to descriptive statistics.

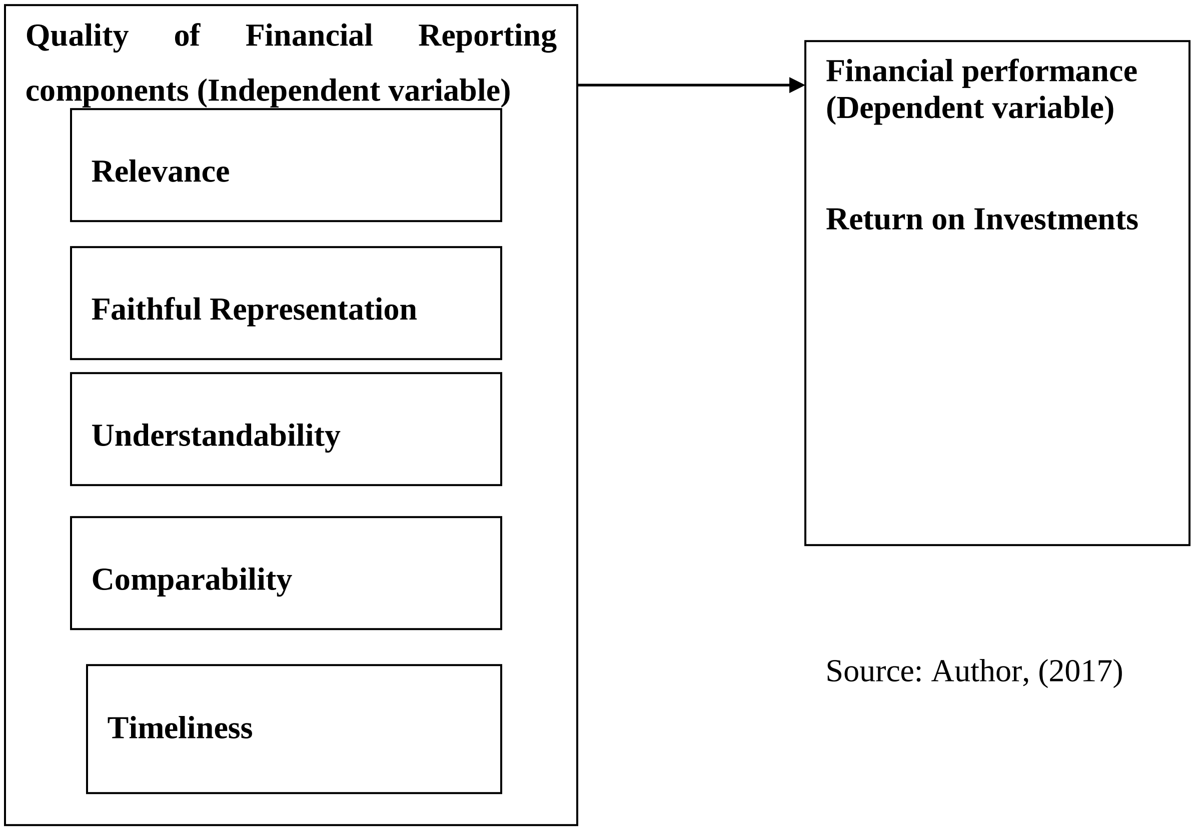
An empirical examination on the determinants of factors influencing financial performance in African countries was carried out in 32 African countries by Stainbank (2014). The study hypothesed that quality financial reporting was mostly influenced by level of economic growth, prevailing levels of education, degree of economic openness, organizational culture and levels of capital market development. Cross sectional data was collected through use of questionnaires and logistic regression analysis was applied to analyse the data. Results of the study revealed significant relationship between United Kingdom cultural adoption, economic development and size of capital markets all had significant influence in quality financial reporting. The choice of logistic regression analysis was appropriate since quality financial reporting could be broadly classified as a bivariate response.

Moreover, Shima and Yang (2012) studied determinants of financial performance through Choi's & Meek's (2008) accounting system development model application. The model broadly classified the determinants as major sources of finance which were equity and debt financing, legal systems adopted by a country, taxation policy, political and economic ties, inflation levels, economic development, education levels and culture. Secondary data was collected from 47 countries which had quality financial reporting for periods 2000 to 2007. Results of the study revealed negative and not significant relationship between equity and quality financial reporting while debt, legal and growth had positive and not significant relationship with quality financial reporting. Further, common wealth based members were influenced positively by quality financial reporting while taxation had negative and significant influence in quality financial reporting.

2.5 Conceptual Framework

A conceptual framework is pictorial framework showing the interrelationships between variables in the study. Currently there is a hypothesized relationship between quality of financial reporting which is characterized by relevance, understandability, faithful representation and comparability of financial statements and financial performance with others. The quality of financial reporting will be operationalized by presence of voluntary disclosure information on general and strategic information, information on financial statement, social and environmental data, financial and market information and presence of other past and future information. The relationship will be as shown in figure 2.1.

Figure 2.1 Conceptual Model



Source: Author, (2017)

2.6 Summary of the Literature

There are glaring empirical gaps which have been persistent in the past studies which have endeavoured to justify the case for reporting quality and financial performance in both developed and developing economies. More so there is persistent choice of small sample which may not be true representative and those which has big sample has collected data from different economic zones which may have different cultural, legal and business environment and hence the applicability of those findings in a specific country may not be justifiable. Furthermore those empirical enquiries which have adopted panel data have pertinently excluded diagnostic tests hence there are higher chances of yielding biased results. On the other hand there are some which have adopted cross sectional data which have been purely analysed using descriptive analysis.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

The section details a methodology that is to be used in executing study. Areas to be covered include the research design, Population target, and sample size, techniques of collecting data, data analysis, validity and reliability of the research instrument.

3.2 Research Design

It is a step by step procedure which was followed in a particular study (Kothari, 2011). Further, Sekaran and Bougie (2013) perceived it as a detailed framework which ought to be followed in a particular study. This research to study financial performance and quality of financial reporting in companies listed at NSE in Kenya. Currently descriptive research design was adopted. Descriptive design helps in describing characteristics of a population or phenomenon under study. This enabled the obtaining sizeable and substantial data from the population.

3.3 Target Population

The universal set composed of all elements or individuals under consideration is known as the target population (Kothari, 2011). All members of this target population ought to be uniquely identified, (Oso & Onen, 2009). Further, Kombo and Tromp (2006) perceived target population as individuals or elements which are under investigation. The target population was composed of all the 68 companies which are currently listed in Nairobi Securities Exchange (NSE, 2016).

Although, target population ought to be wholly considered in a study it is not possible owing to budgetary and timely constraints, therefore there is need to consider a subset of the total population to be the true representative in a study (Kothari, 2011; Sekaran & Bougie, 2013). Owing to the size of the target population the current will adopt census approach and collect data from annual statements of listed companies for a period of five years ranging from 2012 to 2016.

3.4 Data Collection

Data collection methods include interview guide, questionnaires, focus group guide and document guide analysis. Currently, secondary data was collected using document check index.

The strength and suitability of the document check index is founded on the fact that it is easier, faster and clear to fill structured as opposed to other methods of data collection, mainly because the information was retrieved from secondary sources (Kothari, 2011; Sekaran & Bougie, 2013). This document check index was structured into two sections, financial performance and quality of financial information. The tool was used to gather information from annual statements of listed companies for a period of five years ranging from 2012 to 2016.

3.5 Data Analysis

It is the process on how data is organized and arranged to in order to obtain the required information. Consistency, completeness and comprehensiveness of data collected was examined before proceeding. Descriptive statistic was used to describe and analyse data. It assisted in interpreting information through graphs, charts and tables. To determine the variables significance relationship, analysis of variance (ANOVA) was used. The study used regression analysis to determine its objective.

3.5.1 Diagnostic test

Secondary data collected was subjected to normality test to ensure that it`s normally distributed. To make sure that the data within the given period of time has some correlation, that is a relationship between current variable and the past variables, lagging test was done.

The statistical errors identified in the analysis were checked by performing diagnostic tests. The study used Q-Q plot, multicollinearity, homogeneity of variance and pre-regression analysis to test the statistical errors. This was to determine if the data set was well modelled.

3.5.2 The Analytical model

Multiple regression evaluated the nexus between financial performance and quality of financial of firms listed at the NSE. The model is below:

$Y= \alpha+ \beta_1X_1+ \beta_2X_2+ \beta_3X_3+ \beta_4X_4+ \beta_5X_5+\varepsilon$

Where Y= **Financial performance.**

α = intercept

β_1, $\beta2$, β_3, β_4, β_5, = Slope coefficients showing the ratio of change in Quality of financial reporting per unit change in each of the independent variables, ε = error term

X_1 = Relevance, X_2 = Faithful Reporting, X_3 = Understandability, X_4 = Comparability, X_5 = Timely and ε = Error term.

The independent variables X_1, X_2, X_3, X_4, X_5 represent quality of financial reporting.

3.6.3 Operationalization of the Variables

Relevance was assessed by analyzing whether the information disclosed by reports are forward looking such as risks and business opportunities; whether fair value measurement basis is used by the company and if reports provide information on how the company is affected by significant transactions and certain market events.

Comparability testing was done to assess whether there is explanation on the notes on change implications to changes in the company`s accounting policies; whether there is explanation on revision in accounting estimates and judgements; This study also assessed on whether accounting on current period results versus the accounting in the previous periods results; whether firm`s annual report can be compared to information of other organizations.

To assess the faithful representation variable, the study basically investigate on whether the estimates as well as assumptions are well explained by the company reports; whether accounting principles choices are clear in the report; whether report include an unqualified auditor's report and whether the corporate governance information and issues are extensively reported in the disclosures.

Timeliness was measured using days after year end auditors took to sign auditors` report.

Financial performance was measured by focusing of financial perspectives. Return on Investments was used as the measurement of financial performance in the study.

3.6.4 Test of Significance

F test (ANOVA- analysis of variance) was done to establish the significance of the multiple linear regression models. This test checked the significance of the whole regression model with the hypothesis that all the independent variables i.e. (quality of financial reporting) relevance, faithful representation, understandability, comparability and timely has no influence on the dependent variable (financial performance) that is Ho: $\beta_1=\beta_2=\beta_3=\beta_4= \beta_5= 0$ and the alternative hypothesis, that at least one of the independent variable is not equal to zero that is H_1: $\beta j \neq 0$; j=1, 2, 3, 4, 5.

The null hypothesis is rejected if the p-value is greater than the common alpha level of 0.05, which indicates that it is not statistically significant (Kothari, 2011). The null hypothesis is rejected if F calculated > F critical hence concluding that at least one of β1, β2, β3, β4 or β5 is not equal to zero.

CHAPTER FOUR
DATA ANALYSIS AND RESULTS

4.1 Introduction

The study was to establish if there is a relationship between financial reporting quality and performance of listed companies at Nairobi securities exchange. Objective and corresponding hypotheses were derived for the study.

4.2 Tests for Statistical Assumptions

Statistical procedures using correlation, regression, t-test analysis and assessment of variance are based on the assumption that there is a normal distribution in the data. The statistical errors identified in the analysis were checked by performing diagnostic tests. The study used Q-Q plot, multicollinearity, homogeneity of variance and pre-regression analysis to test the statistical errors. This is to determine if the data set was well modelled.

4.2.1 Tests of Normality

Techniques of statistical nature requires supposition of normality to be tested. It will assist the graphical tests to be achieved in connection to the data normality and also enables the skewness and kurtosis coefficients to be tested. It authorizes whether a normal dissemination is monitored by data or not. If the normality is not attained, the regression analysis for goodness of fit, the findings may not portray the true picture association amongst variables. According to the central limit theorem (CTL), if the sample data are roughly normal, then the sampling distribution will be normal (Krishman, 2006). In the study the normality was tested using the Shapiro- Wilk Test. Shapiro-Wilk Test is more suitable or most influential normality test (Razali and Wah, 2011). It is a more reliable test for creating skewness and kurtosis values of normality. If it is below 0.05, the data meaningfully deviate from a normal distribution. Results for the test of normality are presented in Table 4.1.

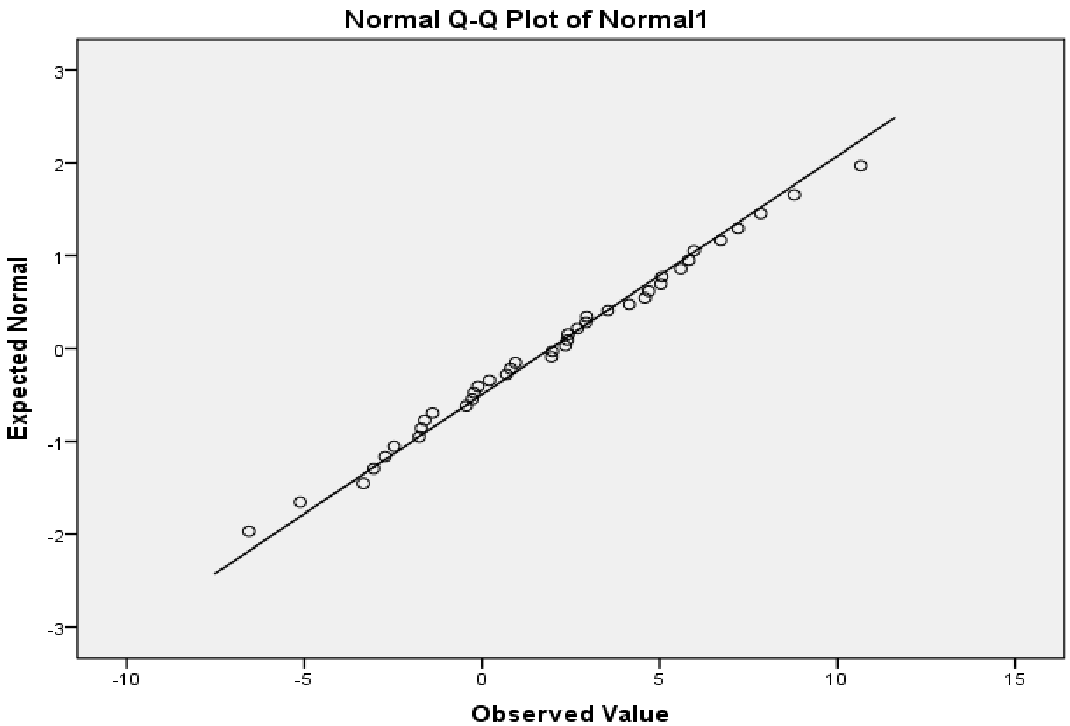
Table 4.1 Shapiro-Wilk Test of Normality

Variables	Shapiro-Wilk		
	Statistic	Df	Sig
Relevance	.986	1.352	0.000
Faithful reporting	.865	1.283	0.000
Understandability	.985	1.361	0.000
Comparability	.965	1.241	0.000
Timely	.985	1.221	0.000

Source: Research Data (2017)

The results of the Shapiro-Wilk Test are presented in table 4.1. It`s presented that Relevance, Faithful Reporting, Understandability, SGG, Comparability and timely and the dependent variable of firm performance were normally distributed. The results were (0.000, 0.00, 0.000) higher than 0.05 checking that there was normality in data.

For a normality decision to be made in detail, a normal Q-Q Plot output is used. The data points will be close to the diagonal line if the data are normally distributed. The data are not customarily distributed if the data points stray from the line in an understandable non-linear. Results of Q-Q plot performance is accessible in figure 4.1.



Source: Research Data (2017)

Figure 4.1: Q-Q Plot

Results from figure 4.1 shows that the rings all lie close to the diagonal line; this is a clear indication that data come from a normal distribution. The data in this Q-Q plot also is normally distributed. There's a slight random twist about the line; this does not exclude these data from being normal.

4.2.2 Multicollinearity Test

Multicollinearity refers to unwanted situation where the independent variables correlation is high. It upsurges the factors` standard errors by applying data with collinearity hence getting variance inflation factor (VIF) and tolerance. The quantity of variance in independent variable not defined by the other independent variable is referred to as tolerance. VIF is a measure of how much variance the regression coefficient is overstated by multicollinearity, thus deceptively expanding standard errors. The tolerance minimum cut off value is characteristically (0.10)

(Keith, 2006). When there is no difficult with multicollinearity tolerance, value ought to be less than (0.10) while VIF value should be additional than (10).

The Variance Inflation Factor (VIF) was also functional to asses' multicollinearity. The VIF values should not surpass 10 and the tolerance values should not be less than 0.10 (Keith, 2006).The maximum satisfactory VIF cut off value is (10). Where there are no two variables which are correlated, then all VIFS will be 1. Where the VIF for one variable is ≥5, then there exist collinearity linked with that variable.

Table 4.2 Multicollinearity Test

Model		**Unstandardized Coefficient**		**Std. Coefficient**			**Collinearity Statistics**	
		Beta (β_0)	Std Error	Beta (β_0)	t-value	Sig.	Tolerance	VIF
1)	(Constant) Relevance	1.762	1.009		1.835	.095		1.263
2)	(Constant) Faithful reporting	-.690	.514	-.372	-1.327	.214	.957	1.013
3)	(Constant) Comparability	.172	.186	.259	.921	.378	.997	1.023
4)	Undersandability	-.650	.516	-.331	-1.335	.212	.957	1.102
5)	Timely	.142	.123	.259	.831	.334	.917	0.012

a. Dependent Variable: Financial performance

Source: Research Data (2017)

Collinearity or multicollinearity which denotes to the supposition that independent variables are uncorrelated or correlated (Keith, 2006). A correlation analysis was conceded out in order to create the association between all the key variables. Pearson's product Moment Correlation (PPM) was realistic to study the correlation coefficient between the variables. If the values of

Pearson's exhibit the association between independent variables, this aids as a method for analysing multicollinearity (Allison, 1999).

A variance inflation factors (VIF) of less than 10 is shown in the table 4.3 results: Relevance strategy (1.263), Faithful Reporting, Understandability 1.013, while Comparability, Timely had (1.023). This suggests that there was no collinearity with the variables.

4.2.3 Tests of Independence

Durbin-Watson test measured the independence of error terms which shows independence of comments. The test check that there was no correlation in the residuals of the models. This is because its part of regression analysis rudimentary hypotheses. Scores between 1.5 and 2.5 designate independent observations (Garson, 2012).

Table 4.3 Durbin Watson Test

Variables	Durbin Watson
Relevance	1.795
Faithful Reporting	2.063
Understandability	2.245
Comparability	2.731
Timely	2.329

Source: Research Data (2017)

The DW data were close to the arranged value of 2.0: Relevance (1.795), Faithful Reporting (2.063) and Understandability (2.245). Thus, it can be determined that variables under the study were independent due to the fact that residuals were autonomous and there was no autocorrelation.

4.2.4 Document Check Index on Financial Reporting Quality

The researcher sought to establish the quality of financial reporting.

Table 4.4 Document Check Index on Financial Reporting Quality

Relevance	**2012**	**2013**	**2014**	**2015**	**2016**
The yearly reports unveils forward-looking information	2.431	3.234	2.432	3.212	3.543
The yearly reports divulges information in terms of business openings and risks	3.782	2.432	3.543	4.542	5.432
The company uses reasonable value as measurement base	4.789	4.231	4.541	4.212	2.435
The twelve-monthly report offers report about how significant transactions and several market events affected the company?	4.234	3.543	5.541	3.432	3.201
Total measurement score for Relevance (overall mean)	**2.614**	**3.36**	**4.014**	**3.849**	**3.652**

The findings from table 4.4 shows that the annual reports disclose forward-looking information had an overall mean of 3.497 for five years studied. On the other hand, the yearly reports disclose reports in terms of business openings and dangers information had an overall mean of 3.214 for five years studied. The company uses reasonable value as measurement base had an overall mean of 4.213. The yearly report offers report about how significant transactions and several market events affected the company had an overall mean of 3.243.

4.2.5 Faithful Representation

Results on Faithful Representation were represented in table 4.5.

Table 4.5 Faithful Representation

Faithful Representation	**2012**	**2013**	**2014**	**2015**	**2016**
The yearly report explains the expectations and estimates made evidently	2.342	3.421	4.432	3.210	3.432
The choice of accounting values clearly explained by the	1.453	2.905	2.432	2.431	4.324

yearly report.					
The confident and negative events are highlighted in a sensible way in the yearly report when discussing the annual results	3.651	3.212	4.321	3.453	2.311
An unreserved auditor's report is included in the yearly report.	2.823	4.541	3.321	2.431	2.231
The corporate governance disclosures made in the annual report.	2.901	3.453	2.543	3.212	3.543
Total measurement score for Faithful Representation (overall mean)	**3.292**	**4.83**	**4.262**	**3.684**	**5.119**

The expectations and estimates made clearly in the annual report had an overall mean of 2.154 for five years studied. The accounting principles clearly explained in the report had an overall mean of 3.134. The confident and negative events are highlighted in a sensible way in the yearly report when discussing the annual results had an overall mean of 3.214. The yearly report includes a definite examiner's report had an overall mean of 4.224. The corporate governance disclosures made in the annual report had an overall mean of 4.127.

4.2.6 Understandability

Results on Understandability were represented in table 4.6.

Table 4.6 Understandability

Understandability	**2012**	**2013**	**2014**	**2015**	**2016**
The yearly report is a well organized	3.654	2.121	3.212	1.211	2.321
The balance sheet and the income statement minutes are clear	2.781	1.321	4.298	2.231	2.321
The information presented explained in graphs and tables	3.451	1.432	2.432	3.213	4.325
The use of practical jargon and language is easy to follow in the yearly accounts	4.762	2.342	2.341	2.123	4.323
The yearly report included a wide-ranging glossary	2.543	3.231	3.211	3.431	4.542
Total measurement score for Understandability (overall mean)	**4.297**	**2.611**	**3.873**	**3.052**	**5.539**

The yearly report is an efficient had an overall mean of 3.154 for five years studied. The balance sheet and the income statement notes are perfect had an overall mean of 3.114. The information offered clarified by graphs and tables had an overall mean of 3.244. The use of practical jargon and that of language is easy to follow in the yearly accounts had an overall mean of 3.251. The twelve-monthly report included a complete glossary had an overall mean of 3.453.

4.2.7 Comparability

Results on Comparability were represented in table 4.7.

Table 4.7 Comparability

Comparability	**2012**	**2013**	**2014**	**2015**	**2016**
The accounting policies variations notes explain the insinuations of given changes	3.232	2.124	4.211	3.212	4.321
The amendments in office estimates and judgments notes explain the insinuations of the revision	2.321	3.212	3.217	4.323	3.220
The preceding accounting period's figures are attuned for the application of revisions in accounting approximations or a change in accounting policy effect.	2.320	3.321	3.321	4.841	2.312
Current accounting period results are associated with previous accounting periods results	3.801	2.432	4.342	2.832	2.809
The yearly report information is similar to information provided by other organizations	3.432	3.743	3.905	4.231	3.521
The yearly accounts shows ratios and monetary index numbers.	3.632	2.891	2.342	3.901	2.792
Total measurement score for Understandability (overall mean)	**3.695**	**2.862**	**3.556**	**4.203**	**3.162**

The changes in accounting procedures notes had an overall mean of 4.234 for five years studied. The amendments in office estimates and judgments notes explain the insinuations of the revision had an overall mean of 3.220. The preceding accounting period's figures are attuned for the application of revisions in accounting approximations or a change in accounting policy effect had an overall mean of

2.312. Current accounting period results are associated with previous accounting periods results had an overall mean of 2.809. The yearly report information is similar to information provided by other organizations had an overall mean of 3.521.The yearly accounts shows ratios and monetary index numbers had an overall mean of 2.792.

4.2.8 Timeliness

Results on Timeliness were represented in table 4.8.

Table 4.8 Timeliness

Timeliness	2012	2013	2014	2015	2016
Natural logarithms on the number of days it took after to sign after auditing of the financial statements	3.121	2.311	3.232	3.109	3.432

Natural logarithms on the number of days it took after to sign after auditing of the financial statements had an overall mean of 3.041 for five years studied.

4.3 Quality of Financial Statement and financial performance

The preceding section has results on the quality of financial statement.

4.3.1 Financial performance

The researcher sought to establish quality of financial performance focusing on financial information. The results were recorded in table 4.9.

4.12: Firm's Financial Performance

Results on analysis of firm performance for a period of five years are tabulated in Table 4.10.

Table 4.9 Analysis on information on Firm's Financial Performance

Criteria	Unit of Measurement	5 Year Achievements				
		2012	2013	2014	2015	2016
A. Financial Perspective						

Return on Investment	%	0.73	-0.02	0.64	0.66	0.67

Source: Research Data (2017)

According to findings analysis, looking at the firm's performance from the financial perspective, there was an upward increase in return on investment for five year period under analysis. 2012 being the base was noted to have an increase of 0.73%, 2013 had a decrease of 0.02%, 2014 had 0.64%, 2015 had a 0.66% increase, while 2016 had a 0.67% increase.

4.3 Inferential Statistics

The inferential statistics were obtained by regression analyses. Subsections below presents the results.

4.3.1 Regression Analysis

The regression findings are accessible in Table 4.8, 4.9 and 4.10.

Table 4.10: Model's Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.524[a]	.639	.403	.1322	1.261

a. Predictors: (Constant), Relevance, Faithful Reporting, Understandability, Comparability and Timely

A virtuous linear connotation between the dependent and independent variables used in the study was shown in table 4.8. Which is presented by a correlation (R) coefficient of 0.639. The Strong association between dependent and independent variables of 0.403 is the determination coefficient which is measured by the adjusted R-square. This portrays interpretations for 50.43% of the total explanations while 49.57% is the unexplainable part of the model.

Table 4.11: Analysis of Variance (ANOVA)

	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.764	3	4.341	12.822	.000[a]
	Residual	14.336	35	.300		
	Total	21.150	44			

The regression model significance was presented by the ANOVA in Table 4.9. An F-significance value of p = 0.000 was established. Hence significance of the model.

Table 4.12: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Model	**B**	**Std. Error**	**Beta**	**T**	**Sig.**
(Constant)	0.320	0.280		1.172	.248
Relevance	0.437	0.134	0.269	2.331	.025
Faithful Reporting	0.134	0.142	0.151	1.134	.264
Understandability	0.456	0.102	0.329	1.759	.087
SGG	0.427	0.134	0.229	2.321	.025
Comparability	0.144	0.142	0.121	1.224	.242
Timely	0.432	0.122	0.229	1.259	.067

a. Dependent Variable: Financial Performance

Table 4.13 Independent influence of financial reporting quality and financial performance

	R	R-squared	Adjusted R-Squared	R-squared change	F Change	df 1	Df2	Sig. F change	Durbin Watson
1	.165[a]	.022	.017	.027	2.876	4	410	.023	
2	.280[b]	.078	.067	.051	22.619	1	409	.000	1.540

Dependent variable: Financial Performance.

Source: Research Data (2017)

Based on model 2 in the Model Summary Table 5.1 where the predictors were supplementary, ($F (1,409) = 22.619$; $P < .05$), the findings designate that the predictors variable, Relevance, Faithful Reporting, Understandability, SGG, Comparability and timely brought about the relationship with the dependent variable, financial performance.

The F-statistic of 22.619 with a probability ratio of .000 indicated that the general model was substantial and that all the independent variables were together significant in explaining the difference in the dependent variable (Financial Performance). Therefore the hypothesis that change in R^2 was equal to 0 was accepted.

4.4 Interpretation of Findings

The results indicates that the annual reports of the listed at stock exchange disclose forward-looking information. On whether the corporation uses fair value as degree basis scored a mean of 4.213. The study indicated that the yearly report offers feedback information on how numerous market events and important communication affected the corporation.

The yearly report of the corporation under the study explains the prospect and estimate made evidently had al mean of 2.154. The yearly report explains the optimal of accounting principles clearly thus providing a basis for crucial decision making for the top management. The yearly financial reports of the firms studied indicate the optimistic and negative events in a balanced way when deliberating the yearly results. The yearly report includes a definite examiner's report had an overall mean of 4.224.

The financial yearly reports indicate efficiency with a mean of 3.154. The notes to the balance sheet and the revenue financial statements are perfect. The study further reveals that the notes to changes in accounting procedures explain the insinuations of the change. The notes to amendments in accounting estimates and judgments explain the insinuations of the revision. The corporation's preceding accounting period's figures are accustomed for the effect of the application of a change in accounting policy or amendments in accounting estimations had an overall mean of 3.24. The results of present accounting epoch are linked with results in preceding accounting periods.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter five entails the study summary, conclusions and policy and choices recommendations from the findings of research.

5.2 Summary

Its indicated that where there was relevance, faithful reporting, understandability, comparability and timely in reporting the financial performance in terms of return on investments were higher than for companies with lower financial reporting quality. The accounting reports are well organized, clearly illustrated statement of financial position and income statement, use of simplified accounting language and a well elaborated glossary of terms used in the financial statements. Moreover, they purported on the need to sign and authenticate annual statements on time more so after auditing report has been prepared and agreed upon.

More so the accounting reports from the companies listed at the Nairobi stock exchange include information which shows that any amendments of changes in accounting policies from one period to another are discussed in detail. Further, comparative analysis between the current and previous period should is well discussed and presented in a clear format and where possible graphs are drawn.

However, reports from Home Afrika Ltd, Kurwitu Ventures and Olympia Capital Holdings ltd did not justify on the accounting procedures which were followed, clearly elaboration of positive and negative investment related issues and free disclosure of corporate governance issues.

5.3 Conclusion

Findings of the study indicate the existence of a relationship between reporting quality and financial performance of listed companies at Nairobi securities exchange. The effect of financial reporting quality on financial performance is positive and significant and the greater the degree of financial reporting quality, the greater the propensity of a firm making substantial net profit margins.

5.4 Recommendations for policy and practice

The study recommends that to ensure adherence to regulations and absolute compliance with standards, stiffer penalties in the form of fines and sanctions capable of serving as deterrent to companies that breach compliance with the new regulations by not publishing their audited annual financial reports within 90 days (3 months) period after the end of their respective financial year.

The study further recommends that regulatory institutions or oversight bodies' central Bank of Kenya should pay greater attention to the content of financial reports as corporate directors or managers may deliberately not comply with certain standard or requirements with the intent to achieving opportunistic targets.

5.5 Limitations of the study

The researcher encountered problems in accessing most recent financial reports on some company's websites. However, the researcher made visits to Nairobi securities exchange and physically acquired the hard copies for the missing companies.

Time was also another limiting factor. The time required to collect this data from all the companies listed was limited.

5.6 Areas for further studies

Further studies should be carried on the relationship between financial reporting quality and financial performance of companies that are not listed at Nairobi securities exchange**.**

Further studies should be carried on the relationship between financial reporting quality and general performance including non-financial, corporate governance, employee's perspective of companies listed at Nairobi securities exchange**.**

The focus of study should also be on other measures of financial performance such as liquidity ratios, gearing ratios etc.

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APPENDICIES

Appendix 1: Document Check Index

FINANCIAL REPORTING QUALITY

Relevance	**2012**	**2013**	**2014**	**2015**	**2016**
The annual reports discloses forward-looking information					
The annual reports discloses information in terms of business opportunities and risks					
The company uses fair value as measurement basis					
The annual report provides feedback information on how various market events and significant transactions affected the company?					
Total measurement score for Relevance					
Faithful Representation	**2012**	**2013**	**2014**	**2015**	**2016**
The annual report explains the assumptions and estimates made clearly					
The annual report explains the choice of accounting principles clearly					
The annual report highlights the positive and negative events in a balanced way when discussing the annual results					
The annual report includes an unqualified auditor's report					
The annual report extensively discloses information on corporate governance issues					
Total measurement score for Faithful Representation					
Understandability	**2012**	**2013**	**2014**	**2015**	**2016**
The annual report is a well organized					
The notes to the balance sheet and the income statement are clear					
Graphs and tables clarify the information presented					
The use of language and technical jargon is easy to follow in the annual report					
The annual report included a comprehensive glossary					
Total measurement score for Understandability					
Comparability	**2012**	**2013**	**2014**	**2015**	**2016**
The notes to changes in accounting policies explain the implications of the change					
The notes to revisions in accounting estimates and judgments explain the implications of the revision					
The company's previous accounting period's figures are adjusted for the effect of the implementation of a change in accounting policy or revisions in accounting estimates					
The results of current accounting period are compared with results in previous accounting periods					
Information in the annual report is comparable to information provided by other organizations					
The annual report presents financial index numbers and ratios					

Total measurement score for Comparability					
Timeliness	**2012**	**2013**	**2014**	**2015**	**2016**
Natural logarithms on the number of days it took after to sign after auditing of the financial statements					

Section B: FINANCIAL PERFORMANCE

9. Please provide the following information on firm's performance

CRITERIA	Unit of Measurement	2012	2013	2014	2015	2016
A. Financial Perspective						
Return on Investment	**%**					

Kindly put down any other comment with respect to the subject of this study.

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Appendix II Companies listed in Nairobi Securities Exchange as at 2016

AGRICULTURAL	**TELECOMMUNICATION AND**
Eaagads Ltd	**TECHNOLOGY**
Kapchorua Tea Co. Ltd	Access Kenya Group Ltd
Kakuzi	Safaricom Ltd
Limuru Tea Co. Ltd	**AUTOMOBILES AND ACCESSORIES**
Rea Vipingo Plantations Ltd	Car and General (K) Ltd
Sasini Ltd	Sameer Africa Ltd
Williamson Tea Kenya Ltd	Marshalls (E.A.) Ltd
COMMERCIAL AND SERVICES	
Express Ltd	**BANKING**
Kenya Airways Ltd	Barclays Bank Ltd
Nation Media Group	CFC Stanbic Holdings Ltd
Standard Group Ltd	Diamond Trust Bank Kenya Ltd
TPS Eastern Africa (Serena) Ltd	Housing Finance Co Ltd
Scangroup Ltd	Kenya Commercial Bank Ltd
Uchumi Supermarket Ltd	National Bank of Kenya Ltd
Hutchings Biemer Ltd	NIC Bank Ltd
Longhorn Kenya Ltd	Standard Chartered Bank Ltd
INSURANCE	Equity Bank Ltd
Jubilee Holdings Ltd	The Co-operative Bank of Kenya Ltd
Pan Africa Insurance Holdings Ltd	**MANUFACTURING AND ALLIED**
Kenya Re-Insurance Corporation Ltd	B.O.C Kenya Ltd
CFC Insurance Holdings	British American Tobacco Kenya Ltd
British-American Investments Company (Kenya) Ltd	Carbacid Investments Ltd
CIC Insurance Group Ltd	East African Breweries Ltd
INVESTMENT	Mumias Sugar Co. Ltd
Home Afrika Ltd Kurwitu Ventures	Unga Group Ltd Flame Tree Group Holdings Ltd
City Trust Ltd	Eveready East Africa Ltd
Olympia Capital Holdings ltd	Kenya Orchards Ltd
Centum Investment Co Ltd	A.Baumann CO Ltd
Trans-Century Ltd	**ENERGY AND PETROLEUM**
CONSTRUCTION AND ALLIED	Kenol Kobil Ltd
Athi River Mining	Total Kenya Ltd
Bamburi Cement Ltd	KenGen Ltd
Crown Berger Ltd	Kenya Power & Lighting Co Ltd
E.A.Cables Ltd	
E.A.Portland Cement Ltd	

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