

**THE EFFECT OF ADOPTING INTERNATIONAL FINANCIAL REPORTING
STANDARDS ON QUALITY OF ACCOUNTING REPORTS OF SMALL AND
MEDIUM ENTERPRISES IN NAIROBI COUNTY**

BY

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DECLARATION

This research project is my original work and has never been presented to any other examination body. No part of this work should be reproduced without my consent or that of the University of Nairobi.

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Despite the assistance accorded to me from these people, I am solely responsible for this final report. It is a product of my efforts.

DEDICATION

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

ABSTRACT

This study sought to establish if the adoption of International Financial Reporting Standards (IFRS) by SMEs in Nairobi County has been associated with higher accounting reports quality. The International Accounting Standards Board (IASB), in its objectives and preamble, supposes that the beneficial effects from IFRS adoption include transparency, accounting quality and reduced cost of capital. Based on these assumptions, this study applied accounting quality measures; faithful representation, comparability, timeliness, understandability and value relevance to find out whether the adoption of IFRS has led to improvements in accounting reports quality of Small and Medium Enterprises in Nairobi County. The methodology is based on prior literature definition of metrics of accounting quality mainly testing the relevance of information, timeliness of accounting information, faithful representation of accounting information and value relevance. The study measured the reaction of the respondents when IFRS was introduced. 41.3 percent of the respondents felt that the introduction of IFRS was stressful, 34.78 percent felt indifferent about the introduction of IFRS, and 23.91 percent also felt that the introduction of IFRS was good.

The results of the correlation analysis showed that there was a positive significant relationship between the relevance and quality of accounting reports of SMEs with the application of IFRS ($p = 0.462p < 0.05$). The same applied to faithful representation on quality of accounting reports of SMEs with ($p = 0.582p < 0.05$). The study employed multiple regression analysis where understandability had positive relationship between with quality of accounting reports with $\beta = 0.198$ at a significance level of 0.0001 with the adoption of IFRS. In conclusion adopting IFRS is a very big move for the firms, accounting regulatory body and the government in Kenya because the benefits are more than the demerits as discussed earlier in this report. For every good thing introduced, there are also challenges as well. One of the recommendations is that the government should introduce some incentives to motivate them or they can even start a compulsory adoption of these standards to ensure that all SMEs adhere to the adoption.

TABLE OF CONTENTS

DECLARATION.....	i
ACKNOWLEDGEMENTS	ii
DEDICATION	iii
ABSTRACT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	viii
LIST OF FIGURES.....	ix
LIST OF ABBREVIATIONS	x
CHAPTER ONE.....	1
INTRODUCTION.....	1
1.1 Background of the Study	1
1.1.1 International Financial Reporting Standards (IFRS).....	2
1.1.2 Accounting Reports Quality.....	4
1.1.3 Small and Medium Enterprises	7
1.1.4 IFRS Adoption and Accounting Quality.....	8
1.2 Statement of the Problem	9
1.3 Objectives of the Study	12
1.4 Significance of the Study.....	12
1.4.1 Government of Kenya	12
1.4.2 General Public	12
1.4.3 County Government	13
CHAPTER TWO.....	14
LITERATURE REVIEW	14
Introduction	14
2.2 Theoretical Review.....	14
2.2.1 Conservative Method Theory	14
2.2.2 Liberal Methods Theory	15
2.2.3 Mixed Methods Theory	16
2.2.4 Consistent Methods Theory	17
2.2.5 Positive Accounting Theory	17
2.2.6 Regulations Theories	18

2.2.6.1 Public Interest Theory	19
2.2.6.2 Capture Theory.....	19
2.3 Empirical Literature Review	20
2.4 International Financial Reporting Standards	26
2.5 Financial Reporting by SMEs	27
2.6 Conclusion.....	31
CHAPTER THREE.....	32
RESEARCH METHODOLOGY	32
3.1 Introduction	32
3.2 Research Design	32
3.3 Target Population	32
3.4 Sample Size	33
3.5 Data Collection Techniques	33
3.5.1 Research Instruments.....	33
3.5.2 Data Collection Procedure.....	34
3.6 Data Validity and Reliability.....	35
3.7 Data Analysis	35
CHAPTER FOUR.....	37
DATA ANALYSIS, PRESENTATION AND INTERPRETATION	38
4.1 Introduction	38
4.2 Data Presentation.....	38
4.2.1 Responses Rate.....	38
4.2.2 Reaction towards the introduction of IFRS	38
4.2.3 The difficulties encountered at the first time adoption of IFRS.....	39
4.2.4 Involvement in training activities when IFRS was introduced	40
4.2.5 IFRS has affected the Kenyan - KAS.....	41
4.2.6 Adoption of all the IFRS 1-9.....	42
4.2.8 IFRS adoption brings about high quality financial statement	43
4.2.9: IFRS adoption brings about transparent financial statements.....	44
4.2.10 IFRS brings about comparable financial statements	45
4.3 Correlation Analysis.....	46
4.4 Multiple regression analysis and findings	48
4.5 Summary and Interpretation of Findings.....	49

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	53
5.1 Summary	53
5.2 Conclusion.....	54
5.3 Policy Recommendations	56
5.4 Limitations of the Study	57
5.5 Suggestions for Further Research.....	58
REFERENCES	60
APPENDIX 1	i
RESEARCH QUESTIONNAIRE	i
APPENDIX II.....	v
LIST OF SMALL AND MEDIUM ENTERPRISES (SMEs) IN NAIROBI COUNTY	v
APPENDICES III.....	vi
LETTER TO THE RESPONDENTS	vi

LIST OF TABLES

Table 3.1 Target Population	26
Table 3.2 Sampling Frame	27
Table 4.1: Correlation Coefficients between Dependent Variable and Independent Variables	38
Table 4.2 Multiple Regression Model	39

LIST OF FIGURES

Figure 4.1: Reaction towards the introduction of IFRS.....	31
Figure 4.2: Difficulties encountered at the first time adoption of IFRS	32
Figure 4.3 Involvement in training activity when IFRS was introduced.....	33
Figure 4.4: IFRS has affected the Kenyan KAS.....	33
Figure 4.5: Adoption of all IFRS 1-9	34
Figure 4.6: IFRS is cumbersome by SMEs	35
Figure 4.7: IFRS adoption brings about high quality financial statement.....	35
Figure 4.8: IFRS adoption brings about transparent financial statements.....	36
Figure 4.9: IFRS adoption brings about comparable financial statements.....	37

LIST OF ABBREVIATIONS

IFRS – International Financial Reporting Standards

SME- Small and Medium Enterprises

IASB – International Accounting Standards Board

IAS – International Accounting Standards

IASC – International Accounting Standards Committee

FASB – Financial Accounting Standards Board

PAT – Positive Accounting Theory

GAAP – Generally Accepted Accounting Principles

CBS – Central Bureau of Statistics

ICEG – International Center for Economic Growth

SFS – Strong financial Statement

PFS – Poor financial Statement

NE – No Effect

IFP – Improved Financial Performance

NIFP – Not Improved Financial Performance

RLV – Relevance

FRN – Faithful Representation

UDY – Understandability

CMY – Comparability

TMS - Timeliness

KAS – Kenya Accounting Standards

ED – Exposure Draft

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The role of Small and Medium Enterprises (SMEs) in the current global economies and business environment has been essential as an imperative provider of employment opportunities and widely contributing to the growth of the economy. In Kenya, an SME is defined as an entity that does not have public accountability; publishes general purpose financial statements for external users and whose debt and equity instruments are not traded in the Public market or foreign stock exchange or over the counter market (ICPAK, 2009). Most SMEs activities are legal but rarely comply with official and administrative requirements such as being unregistered; they do not pay taxes as a result of the government inability to enforce the often inadequate regulations.

The adoption of IFRS for SMEs has facilitated the expansion of these organizations in the international trade. The organizations have been able to outsource funds from global stock markets, through facilitating global partnership and encouraging global investors. For example, some of the differences between countries in accounting and financial management make it difficult for harmonization and participation of various organizations' participation in the global trade. Various countries employ different financing methods of their long term investments such as capital market and bank loans. Some countries finance their long term investments through use of bank loans, while others use capital market. This leads to differences in terms of the methods used in valuation of the assets of the business. Therefore, the introduction of the IFRS for small

and medium enterprises will lead to convergence of the methods used in valuation of the assets of the business across globe (UNCTD, 2008).

1.1.1 International Financial Reporting Standards (IFRS)

The international financial reporting standards (IFRS) were developed for the purposes of the publicly traded companies and not for the interest of the owner managed businesses. The IFRS are standards issued by the International Accounting Standards Board (IASB). This has limited the application of the international financial reporting standard for the purposes of the small and medium enterprises (Epstein & Jermakowicz, 2010).

The aims of international financial reporting standards have been to provide information to external users rather than the owners of the business. The most prevalent reason behind non-application of international financial reporting standards have been due to non-recognition of the SMEs by the international accounting standards board when developing the IFRS. This has limited the applicability of these standards by SMEs across the globe. However, IASB has recognized the need to incorporate small and medium enterprises in the IFRS through development of IFRS suitable for the SMEs (Brookfield, 2001). There has been a growing need in the regulatory authorities such as the tax system for proper accounting for small and medium enterprises. Regulatory environment has been among the most prevalent challenges facing small and medium enterprises. This has led to an increasing pressure for small and medium enterprises to fulfill the requirements of accounting (Mirza, Holt, & Knorr, 2011).

The accounting needs of small and medium enterprises are different from the general accounting needs of the normal business enterprises. Small and medium enterprises do not have public accountability in their financial statements preparation. Therefore, there is no need of publishing the financial statements for the purpose of external users. The first International accounting standard (IAS) was published in 1975 by the International Accounting Standards Committee (IASC), which was formed in 1973. Since then, the IAS has undergone substantial evolution. Restructuring of the IASC into the International Accounting Standards Board (IASB) was done in the year 2001. The dominance of IFRS further improved in September 2002 when the United States financial Accounting Standards Board (FASB) and IASB signed the Norwalk Agreement. These two bodies undertook to work closely to develop high quality compatible accounting standards to be used both for domestic and cross border financial reporting. As a consequence of the joint project to coverage the more principle based IFRS and more rules-based US GAAP, both boards agreed to develop new joint Conceptual Framework, which accounting standards ought to based. In May 2008, the FASB and the IASB published an exposure draft of ‘An improved Conceptual Framework for Financial Reporting’ (IASB, 2008; FASB, 2008). This Conceptual Framework represents the foundations of the accounting standards. “The application of objectives and qualitative characteristics should lead to high quality accounting standards, which in turn should lead to high quality financial reporting information that is useful for decision making” (FASB, 1999; IASB, 2008). As at May 2011, thirteen IFRS had been issued. The IFRS for SMEs comprised of 9 IFRS. The International Accounting Standards Board (IASB) intends to issue a comprehensively reviewed IFRS for SMEs after the 2009 version has been used for two years, to address

any issues that may arise. Thereafter, a compilation of amendments will be issued every three years (ICPAK, 2009).

1.1.2 Accounting Reports Quality

Financial reports can only be regarded useful if they represent the “economic substance” (Penman, 1984). The implementation of IFRS would reduce information irregularity and strengthens the communication link between all stakeholders (Bushman and Smith, 2001). Ahmed (2003), stated that useful accounting information derived from qualitative reports help in efficient allocation of resources by reducing dissemination of information of asymmetry and improving pricing of securities (Spiceland et al. 2001).

Those in favor of IFRS adoption also argued that the standards enhance comparability of financial statements across countries and markets, which is also a component of high quality financial reporting (Pownall and Schipper, 1999). Relevance is referred to us the “capability of making a difference in the decisions made by users in their capacity as capital providers” (IASB 2008).

Relevance is operationalised using four items referring to predictive and confirmatory value. As mentioned earlier in the study, researchers tend to focus on earnings quality instead of on financial reporting quality. This definition neglects the non financial information and excludes ‘future’ financial information already available to the users of the annual report, for example on future transactions (Jonas and Blanchet, 2000; Nicholus and Wahlen, 2004).

This study will consider a broader perspective on predictive value to measure quality of accounting reports. Predictive value explicitly refers to information on the firm’s ability to generate future cash flows: “information about an economic phenomenon has a

predictive value if it has value as an input to predictive processes used by capital providers to form their own expectations about the future” (IASB 2008). Information is said to have a confirmatory value “if it confirms or changes past (or present) expectations based on previous evaluations” (IASB 2008). Jonas and Blanchet (2000) argued that if the information in the annual report provides feedback to the users of the annual report about previous transactions or events, this will help them to confirm or change their expectations.

Faithful representation is the second fundamental qualitative characteristic as elaborated by ED. This entails representing economic phenomena that information purports to represent, annual reports must be complete, neutral and free from material error (IASB, 2008; 36). The economic phenomena represented in the annual report are “economic resources and obligations, transactions and other events and circumstances that change them” (IASB, 2006). Consistent with prior literature, faithful representation is measured using five items referring to neutrality, completeness, freedom from material error and verifiability (Dechow et al., 1996; McMullen, 1996; Beasley, 1996; Rezaee, 2003; Cohen et al., 2004; Sloan, 2001; Jonas and Blanchet, 2000; Maines and Wahlen, 2006; Gaeremynck and Willekens, 2003; Kim et al., 2007; Willekens, 2008).

Faithful representation first proxy refers to ‘free from bias’. An annual report can never be completely be free from bias, as the economic phenomena presented in annual reports are frequently measured under conditions of uncertainty and that many assumptions and estimates are included. Although complete lack of bias cannot be achieved, a level of accuracy is necessary for the financial reporting information to be decision useful (IASB,

2008). Thus it's important to examine the argumentation provided for the different estimates and assumptions made in the annual report (Jonas & Blanchet, 2000).

Neutrality is defined as “the absence of bias intended to attain a predetermined result or to induce a particular behavior. It refers to the intent of the preparer; the preparer should strive for an objective presentation of events rather than focusing solely on the positive events that occur without mentioning the negative events. The fourth construct of faithful representation refers to the unqualified auditor’s report. Auditors reports adds value to financial reporting information by providing reasonable assurance about the degree to which the annual report represents economic phenomena faithfully.(Gaeremynck and Willekens, 2003; Kim et al., 2007; Willekens, 2008). Corporate governance information increases the probability of faithfully represented information (Sloan, 2001; Holland, 1999).

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 five items that emphasize the transparency and clearness of the information presented in annual reports (Jonas & Blanchet, 2000; Iu & Clowes, 2004; Courtis, 2005; IASB, 2006). It entails how well organized the information in the annual report is presented. Understandability also includes the disclosure notes to the balance sheet and income statement which may be valuable in terms of explaining and providing more insight into earnings figures (Beretta & Bozzolan, 2004). Additionally the use of tabular and graphic formats may improve understandability by clarifying relationships and ensuring conciseness (IASB, 2006; Jonas & Blanchet, 2000)

Comparability is a second enhancing qualitative characteristic. It is the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena (IASB, 2008). Comparability not only refers to the consistency of the use of accounting procedures by a single company, it also refers to comparability of annual reports of different companies (IASB 2008). When assessing the comparability of annual reports of different companies, the accounting policies used, the structure of the annual report, and the explanation of transactions and other events are of special importance (Jonas & Blanchet, 2000).

Timeliness is the final enhancing qualitative characteristics defined by ED. Timeliness is the having of information available to decision makers before it loses its capacity to influence decisions” (IASB, 2008). 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. Based on the natural logarithm of this amount of days, each company will receive a score between 1 and 5.

1.1.3 Small and Medium Enterprises

The growing importance of SMEs in the global economies has led to a shift of the approach used in management of these enterprises. The authorities have changed their approach of the view of the SMEs due to their growing importance in the economy. This has led to increased pressure for the government to provide training for the entrepreneurs, which is essential for the ease in compliance to various regulations. The participation of SMEs in the global trade has been limited due to various factors acting as constraints for

their participation in the international trade. However, there has been a rising concern on the difference of various national accounting and tax systems adopted in various countries (UNCTD, 2008). This has led to increasing pressure on international regulatory authorities such as the International Accounting Standards Board (IASB) to develop International Financial Reporting Standards (IFRS) designed for the needs of small and medium enterprises.

Entrepreneurs have also found the importance of accounting as an important source of information about the business enterprises. There has been a changing approach in how the entrepreneurs understood the importance of internal and external accounting in their business enterprises. It is important for the accounting system used for the small and medium enterprises to meet the various needs through provision of the necessary information. There is also need to account for the administrative capacity of the organization so that provision of necessary accounting records does not burden the organization management (Epstein & Jermakowicz, 2008).

The international financial reporting standards for the SMEs were developed to facilitate the application of the generally accepted accounting standards in the process of preparation and presentation of the financial statements by small and medium enterprises i.e. the preparation of the balance sheet, income statements and cash flows statement. There is need for adoption of the accounting policies and standards providing guidelines for the changes in the accounting errors and estimates (IASB Comittee, 2009).

1.1.4 IFRS Adoption and Accounting Quality

Consistent with the long objective of the IASB, IFRS purport to be set of high quality accounting rules that would ideally be applied consistently by Public Companies globally

to ensure that they are acceptable by capital markets around the World (IASB 2009). As there is no consensus as to what constitutes high quality accounting standards, IFRS are perceived to be of high quality because they represent a collection of the world's best accounting practices and are purported to be more capital market oriented than many domestic accounting standards (Ding et al. 2007). It is posited that the adoption of IFRS is associated with high accounting quality and research by Barth et al. (2008) is a prominent paper in support of this view. By using a sample of firms from 21 countries, Barth et al. (2008) show that firms that adopted IFRS voluntarily exhibit less earnings management, more timely loss recognition and greater value relevance of accounting income. The principles-based nature of IFRS (Carmona and Trombetta 2008) also encourages firms to report accounting information that better reflects the economic substance over form and therefore promotes greater transparency (Maines et al. 2003). With all these findings together support the notion that firms adopting the IFRS are of high quality than those matched sample firms applying local accounting standards. IFRS enhances comparability of financial statements across countries and markets, which is also a component of high quality financial reporting (Pownall and Schipper 1999).

1.2 Statement of the Problem

Majority of the emerging economies and developing economies as well as the developed economies are characterized with small and medium enterprises (Madawaki, 2011). However, their participation in the global trade has been inhibited by various factors both within their internal and external environment. Adoption of the international financial reporting standards by small and medium enterprises will facilitate improvement of accountability in management of the cash flows in the business. It will encourage the

right practices in preparation and management of cash flows in the business by entrepreneurs. The application of international financial reporting standards will prepare the organizations for the growth to public corporations (European Commission, 2012).

In a view to justify the emergence of financial reporting standards for SMEs, the study aims to answer whether: adoption of International Financial Reporting Standards translates to quality financial reports and should the Small and Medium Enterprises adopt these standards as will result in improved financial reporting? This study aims to exploit the unique features offered by Kenyan, Nairobi County SMEs' adoption of IFRS and contribute to the literature examining the effects of adopting IFRS.

Related Studies in Germany by Paananen and Lin (2008), Clarkson et al. (2009), Houque et al. (2010) reported that IFRS adoption does not necessarily lead to improved quality in financial reporting. Paananen (2008) stated that IFRS adoption did not improve the quality of accounting in Sweden and went on to advise that it is dangerous to draw conclusion on using this kind of measure. Chen et al. (2010) also argued that IFRS adoption would not generate accounting information with same quality across the countries as other factors would affect accounting quality. Barth et al. (2007) and Bartov et al. (2005) examined the impact of adoption on accounting quality in firms during pre and post adoption period. It was argue that there is no conclusive evidence that standards have contributed to improvements in accounting quality.

Brochet, Jagolinzer and Riedl (2011) examined the mandatory IFRS adoption and financial statement comparability by examining firms in UK, it was established that the benefits to IFRS adoption are not limited to countries exhibiting large differences between domestic standards and IFRS, or to firms exhibiting low information quality.

Study by Garuba (2012) examined the challenges of adopting IFRS and its proffer solutions that will ensure seamless transition in the Nigeria Economy. The study provided preliminary evidence reflecting that reporting incentives plays an important role in IFRS compliance and the economic benefit of IFRS compliance in a developing country where enforcement is weak. In Australia, the study by Chua, Cheong and Gould (2012) examined the association between IFRS and adoption and accounting quality in the context of Australian capital market where the study compared the specifically the earnings management, timely loss recognition and value relevance of accounting numbers of before and mandatory introduction of IFRS in Australia to determine its effect on accounting quality. It was argued that mandatory adoption of IFRS has resulted in better accounting quality than previously under Australian generally accepted accounting principles. In particular, the findings indicated that the pervasiveness of earnings management by way of smoothing reduced; the timeliness of loss recognition has improved post adoption and the value relevance of financial statement information has improved, especially for non financial firms.

The International Accounting Standards Board (IASB), in its objectives supposes that the beneficial effects from IFRS adoption include transparency, accounting quality and reduced cost of capital. Based on these assumptions, the study on the impact of IFRS adoption on the accounting quality of listed Companies in Kenya by Bova and Pereira (2012) applied accounting quality measures; earnings management, time loss recognition and value relevance to find out whether the adoption of IFRS led to improvements in accounting quality in listed Companies in Kenya between 1995 and 2004. The results reported mixed outcomes in that three out of the eight metrics indicated that quality had

marginally improved while five indicated that it had marginally declined. The study reported that public Kenyan firms do not follow the Companies Act as much as the private firms and that share turnover is positively associated with the level of IFRS compliance, but is negatively associated with foreign ownership and the percentage of holding of a firm's largest foreign shareholder. Nderitu (2010) did a case study on managing growth in small and medium enterprises among members of the Nairobi stock exchange and Mulandi (2010) assessed the impact of microfinance Institutions on micro, small and medium enterprises in Kenya. Wamalwa (2010) did a study on the relationship of executive succession and performance of SMEs in Kenya. However no study has been carried out on the impact of IFRS adoption by SMEs in Nairobi County.

1.3 Objectives of the Study

The main objective of the study is to assess the effect of adopting IFRS on accounting quality of SMEs in Nairobi County.

1.4 Significance of the Study

1.4.1 Government of Kenya

This study is regarded to be essential to provide strategic information to policy makers at the county level enabling it improve its tax collection level through proper accounting systems being put in place by the tax payers.

1.4.2 General Public

Adoption of the international financial reporting standards by small and medium enterprises has been constrained by the non-recognition of small and medium enterprises. However, in the recent periods the international accounting board (IASB) has intervened through development of the international accounting standards for small and medium

enterprises. The adoption of the IFRS will enable the tax payer to get better services as a result of higher collection of taxes from these entities. The entities may make substantial contribution to the local economy in various ways including creation of employment opportunities and provision of social services such as provision of good infrastructure, staff welfare facilities and other social facilities.

1.4.3 County Government

The study will shade light to the ongoing reforms in the county government tax collection administration by reflecting the true and fair view of the financial statements of the SMEs hence resulting to proper planning of available resources.

1.4.4 Lenders

The lenders of SMEs will be interested in information that will enable them to determine whether their loans and the interest attaching to them will be paid on time.

1.4.5 Investors

These are the providers of risk capital and their advisers are concerned with the risk inherent in and return provided by their investments. They need these information to help them determine whether they should buy, sell or hold. The Shareholders are also interested in information which enables them to assess the ability of the entity to pay dividends

CHAPTER TWO

LITERATURE REVIEW

Introduction

The review of literature reviewed what other researchers have done on the study of the impact of SMEs adoption of the international financial reporting standards. Various scholars, authors, international organizations and researchers have developed various perspectives on the importance of Small and medium enterprises adopting international financial reporting standards. This chapter aimed at reviewing what these institutions and individuals who have developed in terms of aspects and knowledge on the importance of IFRS for SMEs. This chapter involved the review of the theoretical literature as well as the empirical literature on the impact of application of the international financial reporting standards for the small and medium enterprises.

2.2 Theoretical Review

2.2.1 Conservative Method Theory

The principle of conservatism is a pervasive concept in modern accounting theory, and is probably a carryover from the days when banks were the primary users of firms' financial statements. Conservatism reflects the idea that, given two equally likely outcomes, a firm should use the accounting method that results in smaller reported income or smaller reported net assets. The accounting concept of conservatism has crossed into the financial analysis arena. Donnelly (1990; as quoted in Revsine et al., 1999) implies in his Wall street journal that conservative accounting is necessary when he states that "low quality means the bottom line is padded with paper gain such as the profit fattening effect of inflation on a company's reported inventory values, or gains produced by under

depreciation,' when the company does not write off plant and equipment as fast as their real value is falling." Bernstein, and Subramanyam (2001) state that " the quality of conservatively determined earnings is perceived higher because they are less likely to overstate current and future performance expectations compared with those determined in an aggressive manner". Comiskey (1971) concluded his research regarding the effects of changing depreciation policies by stating that "The particular set of accounting alternatives can be thought of as adding a unique 'quality dimension' to the earnings. Dhaliwal, et al. (1982) suggests that a switch to straight-line depreciation will lead to materially larger amounts of earnings and equity (i.e., book value) in future years. Their theoretical framework includes the assumption that company managers are concerned with the amount and timing of compensation.

2.2.2 Liberal Methods Theory

Another commonly cited characteristic of high quality earnings is that the earnings should not fluctuate significantly from year to year. Revsine et al. (1999), in a discussion of the merits of using accrual-based vs. cash-based accounting in forecasting future cash flows, state that "accrual accounting produces an earnings number that' smoothes out the unevenness or 'lumpiness' in year-to-year cash flows, and it provides an estimate of sustainable 'annualized' long-run future free cash flows." This purported characteristic of high quality earnings has spawned a large stream of capital markets research exploring the possibility that managers take deliberate steps to "smooth "earnings to give the appearance of higher quality firm earnings. Given this definition of earnings quality and the managers' desire to smooth earnings, it could be argued that firms using only liberal

accounting methods may actually have higher quality (i.e., *smoother*) earnings than those that use a hodge-podge of conservative and aggressive methods.

2.2.3 Mixed Methods Theory

According to this theory, firms using a mix of accounting methods will have higher quality earnings do not use strictly liberal or strictly conservative policies, which will cause the financial statements as a whole to be too liberal or ultra – conservative), thus allowing investors to predict future earnings and book values more precisely. Several analysts admit that ultra conservative accounting policies can lead to lower quality earnings, at least over a longer time horizon. For example, firms that take excessively large write offs in one year (ie “take a bath”) will show greater than normal earnings in all future years. In recent years, these large write offs have often been the result of companies restructuring charges. Wild, Bernstein, and Subramayam (2001), cited earlier as favoring the conservative methods theory of earnings quality, also state that “excessive conservatism, while contributing temporarily to earnings quality, reduces the reliability and relevance of earnings in the longer run. Examining the accounting principles selected can provide clues to management’s propensity and attitudes” The commission on Auditor’s Responsibilities (1978), sponsored by the American Institute of Certified Public Accountants, suggests that financial statement users may be misled about a firm’s liquidity or quality of earnings if the firm uses all extreme (ie., all conservative or all liberal) accounting methods.

2.2.4 Consistent Methods Theory

Another view of the earnings quality question is that managers of mixed portfolio firms have more opportunity to “manipulate” earnings either deliberately or due to the counterbalancing effects of various accounting methods employed (e.g. greater income due to the method of inventory valuation offset by smaller income due to the method of depreciation). Firms that consistently use conservative (liberal) methods, on the other hand, will generally show smaller (greater) income, which will not be offset among the various accounting methods. Both the conservative and liberal firms are theoretically “at the extremes” of the small vs. large reported income levels, and thus have less opportunity to manipulate income. Pincus (1993) states that the “choice of conservative sets of accounting methods leads one to have stronger priors that (cumulative) earnings approximate the lower bound on the earnings levels that could have been reported.” Bushman and Indjejikian (1993) present an analytical model in which biased accounting (ie., conservative and liberal) will be demanded when managers engage in more than one activity and the firm uses a reward system based on management stewardship of the firm’s resources. The model show that, in some situations, an unbiased accounting system may actually produce redundant information that is not useful in making financial decisions.

2.2.5 Positive Accounting Theory

This is an expression of neo-classical economic theory, which believes in an opportunistic behavior as a basis of all economic activity. PAT is the reason for the choice of accounting methods, techniques and policy decisions. PAT describes the organization in terms of a collection of contracts. These contracts are necessary in order

to get self-seeking individuals to agree to cooperate. Examples are contracts with managers, suppliers of capital and employees including managers. These contracts enable the individual party to maximize on the shareholders wealth. The contracts are also associated with contracts costs such as monitoring and maintenance costs, negotiating costs and agency costs. PAT holds that firms will seek to minimize the contracting costs and this will affect the policies adopted including the accounting policies. PAT's three hypothesis are the bonus plan hypothesis, the debt covenant hypothesis and political cost hypothesis. The bonus plan hypothesis suggests that managers of firms will be more likely to choose accounting procedures that shift reported earnings from future periods to the current period. According to Colasse (2000) PAT interferes either on the level of standards setter or on the firm level when standards setter let the choice among several options. Belkaoui (1992) argues that the central idea of the positive approach is to develop hypothesis about factors that influence the world of accounting practices and to test empirically the validity of these hypothesis. According to Watts and Zimmerman (1990), a sole accounting choice can reduce the explicative power of tests.

2.2.6 Regulations Theories

The Economists and lawyers have been studying the diverse theories to explain the regulation and to anticipate when and how markets would be regulated or deregulated. According to Viscusi, Vernon and Harrington Jr. (2000), the regulations theories evolution could be analyzed in the stages, the normative analyses of the Positive theory (Public Interest Theory), the Capture Theory and the Economic Theory of Regulation (Interest Group Theory).

2.2.6.1 Public Interest Theory

The Public interest Theory follows the classical point of view according to which regulation takes care of the Public Interest. Example the State Regulatory agency is a “watch dog” that acts whenever the Public interest is about to be sacrificed. It can step in as a regulator to avoid a firm acting in a natural monopoly market prejudice consumers. According to this theory, the regulation is justified, mainly, in cases that involve natural monopolies and negative externalities. This view implicitly assumes that the incentives of regulators are aligned so as to further the public interest and that the concept public interest is “well defined”. King (2006) suggests that financial accounting rules and Securities Acts issued by the US Congress in 1933 and 1934 were designed to protect the public interest in recovering the confidence on the stock market and in avoiding new crises similar to the great depression.

2.2.6.2 Capture Theory

This theory was developed as an alternative of Public Interest theory, once many empirical evidences supported that regulation were exercised in favor of the regulated firms, in prejudice of the public interest. Beaver (1998) argued that the prime beneficiaries of regulation were not the public (or investors, in the case of the Securities Acts), but rather those being regulated. Viscusi, Vernon and Harrington Jr. (2000) affirm that according to the Capture Theory, “either regulation is supplied in response to the industry’s demand for regulation (in other words, legislators are captured by Industry), or the regulatory agency comes to be controlled by industry over time (in other words, captured by the Industry)”.

2.3 Empirical Literature Review

Chua, Cheong and Gould (2012) examine the IFRS impact on the accounting quality by focusing on three perspectives: the earnings management; timely loss recognition and value relevance. Using four years of adoption experience since the mandate was first made effective in Australia for a wide range of accounting-based metrics and market-based information. The study finds that the mandatory adoption of IFRS has resulted in better accounting quality than previously under Australian GAAP. The study indicates that the pervasiveness of earnings management by way of smoothing has reduced, while the timeliness of loss recognition has improved post adoption. Additionally, the study finds that the value relevance of financial statement information has improved, especially for non-financial firms.

Okpala, (2012) investigate the effect of IFRS adoption on Foreign Direct Investment in Nigeria Economy. The population of the study consists of quoted companies in Nigeria Stock Exchange (Preparers) and Investment Analysts (Users). Using a stratified random sampling method, primary data was used to elicit responses with 123 representing a 30% of the total population of quoted companies in Nigeria Stock Exchange between 2002 and 2011. Structured questionnaires administered. The study findings shows that IFRS has been adopted in Nigeria but only a fraction of the companies has implemented with deadline for the others to comply. Based on the study findings, it was concluded that the adoption of IFRS is a right step in the right direction and that Nigeria companies will produce more credible, uniform and better interpretation of financial statements. This will boost investors' confidence, attract cross border financial transactions and enhance economic growth of the country.

Bova and Pereira (2012) investigate the economic determinants and consequences of IFRS compliance in Kenya where the capital market is open and enforcement of IFRS is lax. The study investigates why firms comply with the IFRS in a developing country where enforcement is weak and whether firms benefit from IFRS compliance in a developing country, Kenya. Using quantitative methods to collect secondary data related to financial reporting such as revenues, income, balance sheet and cash flow data of companies listed in the Nairobi Stock Exchange in the years 1995 to 2004 in Kenya. The study found that public firms appear to have a higher level of IFRS compliance than Private firms in Kenya. The study contributes to the literature by providing preliminary evidence on which reporting incentive plays an important role in IFRS compliance and the economic benefit of IFRS compliance in a developing country where enforcement is weak. The study reported that public Kenyan firms do not follow the Companies Act as much as the private firms and that share turnover is positively associated with the level of IFRS compliance, but is negatively associated with foreign ownership and the percentage of holding of a firm's largest foreign shareholder.

Beest, Braam and Boelens (2009) examined the mandatory IFRS adoption and financial statement comparability by examining firms domiciled in the UK. It was argued that abnormal returns to both insider purchases as well as analyst recommendation upgrades decreased following the IFRS adoption. The findings occur in univariate and multivariate analysis and cross 1-month, 3 months and 6 months return windows. It was concluded that these results are consistent with mandatory IFRS adoption reflecting benefits attributed to improved comparability. The results established that the benefits to IFRS

adoption are not limited to countries exhibiting large differences between domestic standards and IFRS, or to firms exhibiting low information quality.

Mulandi (2010) assessed the impact of microfinance Institutions on micro, small and medium enterprises in Kenya and concluded that the microfinance institutions have a great impact on employment creation and poverty alleviation in the SMEs. The study used a targeted population of 200 and a sample size consisting of 60 enterprises selected using a random sampling technique. It was concluded that micro finance institutions had a great impact on the employment creation and poverty alleviation in the Micro and Small and Medium Enterprises Sector. The study also revealed that major microfinance networks justify their work with expected impact on job creation, with repeat loans and a secured and continuous flow of credit – non family labor may be brought in resulting in employment. The study further concludes that there is a positive impact on equitable distribution of income and wealth as well as on the financial performance of the enterprises.

Nderitu (2010) did a case study on managing growth in SMEs among members of the Nairobi Stock exchange. The study used a case study of Suntra Investment bank (SIB) and it was established that SIB had gone through a full organization life cycle marked by a period of slow growth which lasted about 12 years between 1990 and 2002, followed by a rapid growth experienced between 2003 and 2006 when the company reached maturity and a decline in growth thereafter. It was argued that the growth of the company is highly dependent on the performance of the economy and that the change in government at the end of 2002 was a huge milestone for the company due to increased investor confidence which resulted to an increase in the capital market leading to positive returns. The study

also established that SIB used various approaches including enhancements of management of information systems and management of organization culture while standardization marketing and lobbying the government were used to a lesser extent.

Ngugi (2009) Survey study on the financial challenges faced by small and micro enterprises in Nairobi used a descriptive survey research design targeting small and micro garages operating in Nairobi. The study used a simple random sampling method to select forty garages from the city council licensing department. The study established that these enterprises were facing various financial challenges such as funds to pay rent and salaries, poor management of finances among others.

Beest, Braam and Boelens (2009) study to assess the quality of financial reporting in terms of the underlying fundamental qualitative characteristics (ie relevance and faithful representation) and the enhancing qualitative characteristics (ie understandability, comparability, verifiability and timeliness) as defined in 'An improved Conceptual Framework for Financial Reporting' of the FASB and the IASB (2008). Using 231 annual reports from companies listed at US, UK and Dutch stock markets in 2005 and 2007, tested their compound measurement tool on internal validity, internal validity, inter-rater reliability (Krippendorff's alpha) and internal consistency (Cronbach's alpha). The study findings suggest that the measurement tool used in this study is a valid and reliable approach to assess the quality of financial reports. The measurement tool contributes to improving the quality assessment of financial reporting information, fulfilling a request from both the FASB and the IASB (2008) to make the qualitative characteristics operationally measurable.

Horton, Serafeim and Serafeim (2008) examined the effects of mandatory adoption of international financial reporting standards reporting on firms' information environment specifically on analysts' forecasts accuracy following disagreement and volatility of revisions. The study investigates those firms that voluntarily adopted earlier and those yet to adopt IFRS. Consistent with the existence of externalities, it was argued that during the mandatory transition period to IFRS, all the measures of the information environment improve for all the groups. Although the improvement was not attributed to IFRS adoption, it was inferred that the voluntary adopters benefited more than the mandatory transition due to externalities. It was also concluded that the financial firms do not exhibit significant differences between before and after IFRS adoption in the analyst variable, consistent with the controversy surrounding fair value accounting and the noise that market can impose on earnings. The results reported that the larger the positive difference between IFRS earnings and local GAAP earnings the larger is the improvement in forecast accuracy, agreement or revision smoothness.

Ashbaugh and Pincus (2001) find that for firms in 13 countries, analysts' forecast accuracy increases after they voluntarily adopted IFRS. Additionally, they also find that forecast accuracy is negatively associated with the differences between domestic accounting standards and IFRS. These findings support the argument that by eliminating many differences in accounting standards and standardizing the format of reporting through the use of IFRS, analysts and investors can reduce the need to make adjustments when comparing financial statements internationally (Ball 2006), enabling them to better monitor and evaluate the quality of financial statements across firms (Jeanjean and

Stolowy 2008; Daske et al. 2008). This potentially induces management to provide higher quality information to users for their decision making.

Despite the persuasive arguments that IFRS adoption enhances accounting quality and that some evidence exists supporting the claims, there are also prior studies that suggest the contrary, especially in the mandatory adoption environment. Some evidence exists supporting the claims; there are also prior studies that suggest the contrary, especially in the mandatory adoption environment. Paananen and Lin (2009) find that the development of IFRS had caused accounting quality to worsen over time. Specifically they find that German firms exhibit a fall in accounting quality after they adopted IFRS mandatorily.

Goodwin et al. (2008) investigate the effect of IFRS adoption in Australia on both the accounts and value relevance, by examining the first-time reconciliations to IFRS provided in the first annual accounts that under IFRS.

Despite finding that the adoption of IFRS has resulted in significant adjustments to accounting numbers and ratios, they find mixed findings in terms of the value relevance of the IFRS numbers over those under Australian GAAP, suggesting that financial reporting quality has not been improved as claimed by the IFRC. Jeanjean and Stolowy (2008) examine whether the adopting firms in Australia have managed their earnings between 2002 and 2006. They find that the pervasiveness of earnings management had not changed in Australia. Although each of these studies assessed the accounting quality from different perspective (value relevance and earnings management), both studies are subject to the same limitation of relying on a single measure to investigate the multi-dimensional concept of accounting quality. Also these studies only focused on a short

period of time after the implementation of IFRS in Australia hence, they did not allow sufficient time for the effects of adoption to materialize.

2.4 International Financial Reporting Standards

The International Accounting Standards Board (IASB) was established in 2001 as part of the International Accounting Standards Committee (IASC) Foundation which is governed by twenty two Trustees. The Trustees have the responsibility of appointing the members of the IASB and the associated councils and committees, as well as securing financing for the Organization. The IASB comprises of twelve full time and two part time members who are responsible for the approval of IFRSs and related documents, such as the Framework for the Preparation and Presentation of Financial Statements, exposure drafts and other discussion documents. The IASB was preceded by Board of IASC, which came into existence on 29th June 1973 as a result of an agreement by professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States of America. The Agreement was revised in November 1982, and its constitution further revised in October 1992 and May 2000 by the IASC Board.

The framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. It assist the board of IASC in the development of future IASs and in the reviewing of the existing ones, promotes harmonization of regulations, accounting standards and procedures relating to presentation of financial statements by providing a basis for reducing a number of alternative accounting treatments permitted by the IAS; assist the national setting bodies in developing national

standards; assists the preparers of financial statements in applying the IAS and dealing with topics that may form the subject of an IAS; assists auditors in forming an opinion as to whether the financial statements conform with international accounting standards; assists users of financial statements in interpreting the information contained in financial statements prepared in conformity with the IAS; provides those who are interested in Agreement. By this agreement the bodies undertook to work closely to develop high quality compatible accounting standards that could be used for both domestic and cross border financial reporting.

Other developing countries like Malawi, Zambia, Sierra Leone, Ghana and Kenya were not left behind but took a cue and adopt the IFRS. Controversies existed over the suitability of applying IFRS in developing countries with researchers such as Singh and Newberry (2008) and Chen et al. (2010) arguing that there exist two school of thought in this field i.e. one supporting a single set of global standard and the other opposing the use of IFRS in developing countries arguing that the business environments and institutional frameworks determine the form and content of accounting standards. Barth et al. (2007) and Bartov et al. (2000) argue that there is no conclusive evidence that standards have contributed to improvements in accounting quality. Barth et al. (2003) by extension argued that high quality standards like IFRS may also lead to low quality accounting information depending on the incentives of the preparers.

2.5 Financial Reporting by SMEs

Globalization in the international business environment has led to various numerous changes in the conduct of business by business enterprises. The need for proper accounting systems that harmonize the accounting needs in the global trade for private

business enterprises has led to development of the IFRS standards for SMEs. Proper accounting principles and practices are essential for the development of organizations and increase ability to participate in the international trade. For example, adoption of the right practices and principles of accounting by small and medium enterprises increases their ability to obtain funds from lending institutions. Shortage of funds has been among the major constraints for the growth and development of small and medium enterprises (IASB Committee, 2009). Therefore, adoption of the IFRS for SMEs increases the ability of these organizations to obtain funds for their business.

The adoption of the international financial reporting standards for small and medium enterprises has also been essential in ensuring comparability, in the preparation and presentation of financial statements. This has led to convergence of the standards used for the purposes of accounting for small and medium enterprises. The convergence and harmonization of the practices and principles of accounting has led to increased participation of the SMEs in the global trade. The increased adoption of the IFRS for SMEs has led to increased awareness by entrepreneurs with the aim of developing corporations. Majority of entrepreneurs hold onto cultural and attitudes towards the IFRS, as majority of the companies express the IFRS as overly complex. The high cost in terms of subscriptions fees and other requirements involves high costs to the entrepreneurs (Madawaki, 2011). In addition, the organizations will have to hire new qualified staff for the purposes of accounting in the organization.

Different countries also employ different fiscal policies, which affect the manner in which profits are described. Different accounting systems also involve disproportionate costs allocations involved in the double accounting relative to the needs and revenues of

SMEs. Adoption of the IFRS for small and medium enterprises will contribute to an equality and uniformity in recognition of the revenues and costs around the globe (Philip, et al., 2011). According to various studies there have been increased concerns on the need to develop sound accounting systems in SMEs for the purpose of increasing financial management by the organizations. Adoption of the IFRS for the SMEs has a direct impact on the accounting skills and financial management of the managers and owners of the businesses. This has been attributed to the continued practice of the right practices and principles in accounting. Compliance to the IFRS requires the entrepreneurs to be members of the regulatory bodies operating in their respective countries (Brookfield, 2001).

These regulatory bodies conduct training and educational programs for the entrepreneurs to facilitate understanding of the various accounting principles and practices. This improves the accounting knowledge of the entrepreneurs enabling their skills in financial management. This facilitates adoption of the right accounting practices and principles by small and medium enterprises. Majority of the small and medium enterprises in various countries do not keep complete accounting records due to lack of knowledge. In addition, majority of the entrepreneurs use accounting information inappropriately, when measuring the financial performance of these organizations (Neag, Masca, & Pascan, 2009).

The regulatory authorities in various countries use the financial statements in determining various factors affecting the business. The taxing authorities use the prepared financial statements in determining the amount of tax to be paid by the business. Adoption of IFRS for small and medium enterprises encourages use of the proper accounting practices and

principles and keeping of proper books of account. Therefore, adoption of IFRS by the SMEs will improve the compliance to these regulatory authorities. Regulatory environment has been among the major challenges for the development of small and medium development (Holt, 2010). Therefore, compliance with IFRS for small and medium enterprises will enable the business to operate efficiently. Preparation of good financial statements requires the adoption of various accounting concepts and theories. Majority of entrepreneurs for small and medium enterprises possess little knowledge of the accounting theories and concepts that can be adopted. Therefore, adoption of IFRS for small and medium enterprises enables the entrepreneurs to understand various accounting concepts and theories to use in accounting practices for their business. There are various accounting concepts and theories in accounting practice for small and medium enterprises and overall accounting practice. According to ICPAK pocket book (2009) namely “IFRS for SMEs” stated that the standard requires that the financial statements must at least be presented annually, and should be consistent with prior years, include comparative prior year information, and include all material items.

A complete set of financial statements should include a statement of financial position; a statement of changes in equity; a statement of cash flows; notes to the financial statements and a single statement of comprehensive income or a separate income statement and separate statement of comprehensive income which can be replaced by the statement of income and retained earnings in cases where the only movements in equity for the period relate to profit and loss, dividends, errors and changes in accounting policy. It enables an entrepreneur understand that the concepts and theories used in accounting practice are recognized in international financial reporting standards when preparing

financial statements either for small and medium enterprises or for general accounting practice. For example, the concept of consistency is an essential concept, which ensures that, irrespective of the changes in the business environment consistent accounting methods are applied consistently. The going concern concept also acts as an assurance that the business will continue to be in operations over a long period of time. These concepts not only apply for large organizations accounting systems but also in small and medium enterprises.

2.6 Conclusion

A lot of research regarding compliance with IFRS has been done in both developed and developing countries. Most studies done in Kenya regarding IFRS adoption examined the Listed Companies in Kenya. However, no research has so far been undertaken here in Kenya, on the impact of adopting IFRS by the SMEs on financial performance in Nairobi County. Various mixed results have been experienced on whether adoption of IFRS improves accounting quality hence the need for a further examination between IFRS adoption and improved financial performance in SMEs.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter outlined the methodology that was used in executing the study. The areas covered in this chapter included the research design, Target Population, Sample size, data collection techniques, data analysis and data validity and reliability of the findings.

3.2 Research Design

This study focused on the assessment of the effect of the IFRS adoption by the small and medium enterprises on the financial performance. To achieve the above objective the researcher adopted an event study research design as a principle design. The design enabled the researcher to evaluate the effect of adopting IFRS on quality of accounting reports of SMEs in the Nairobi County. The study included the use of qualitative research methodologies in achieving the objectives of the study.

3.3 Target Population

The total registered SMEs in the Nairobi County according to the Nairobi City Council records were 421 Enterprises. This study analyzed a target population of 150 Enterprises in small and medium enterprises in Nairobi County with the assumption that they had adopted the IFRS in their accounting practice. Cooper and Schindler (2001) defined population as the total collection of elements about which one wants to make some inferences. Categorically the study population constituted of 100 Small Enterprises who paying a license fee of between kshs 80,000.00 to Kshs 95,000.00 and 50 Medium Enterprises who pays licence fee of Kshs 95,001 and above (see Appendix III). The study population constituted only those SMEs that keep proper books of accounts.

Table 3.1 Target Population

Category	Population	Percentage
Small Enterprises	100	67%
Medium Enterprises	50	33%
Total	150	100%

Source: Author 2013

3.4 Sample Size

According to Cooper and Schindler (2001), a sampling frame is the list of elements from which the sample is actually drawn. The selection of the sample was done through stratified random sampling whereby Enterprises were grouped into two, the Small Enterprises and Medium Enterprises. The Small Enterprises constituted those paying a license fee of between kshs 80,000 to kshs 95,000 while the Medium Enterprises are those paying a licence fee of kshs 95,001 and above. To ensure that there is no biasness in the data collection process a random sample was conducted to select the sample size. Random sampling is effective in ensuring that the data collected reflects the concerns of the population. This researcher collected data from a sample of 70 Enterprises selected randomly from the population of study.

Table 3.2 Sampling Frame

Category	Population	Sample	Percentage
Small entrepreneurs	100	50	50%
Medium Firms	50	20	40%
TOTALS	150	70	46.7%

Source: Author 2013

3.5 Data Collection Techniques

3.5.1 Research Instruments

Various methods of collecting primary data were adopted in the inquiry such as observation, questionnaires and interviews. The questionnaire was adopted as the

principal data collection instrument because it is to be administered across the board. This instrument was principally structured and designed carefully to ensure that it carries questions capable of providing answers to all the research questions. As an instrument design strategy, complete structuring of the questionnaire was relevant for analysis purposes when coding and tabulating information. The researcher analytical skills were utilized to gauge the respondent feedback i.e. observation. Structured questions were essential in ensuring that the respondents do not divert from the required response required by the researcher. The observation method enabled the researcher identified the methods used by the entrepreneurs in maintaining their records of financial statements.

3.5.2 Data Collection Procedure

The procedure adopted during data collection was in three stages: Pilot study, pre- study sessions and finally administration of research instruments for data collection. The pilot study aided the researcher in measuring the validity and reliability of the designed collection instruments. The questionnaires were self-administered but data collected through observation will be noted down. As a strategy aimed at minimizing the time it took to carry out the exercise, the researchers adopted both self-administered and drop and pick strategies in questionnaire administration. The primary data was collected using a questionnaire (see appendix) and observation techniques. Secondary data was gathered by reviewing a wide range of documents including journals (see references), ICPAK newsletters, survey results for National Micro and Small Enterprise Baseline Survey 1999 booklet which was conducted by the Central Bureau of Statistics (CBS), International Center for Economic Growth (ICEG) and K- Rep Holdings Ltd. Various books used included the International Financial Reporting Standards (IFRS) 2007,

Accounting, Research Methods books and Financial Management books among others. (See reference section).

3.6 Data Validity and Reliability

The reliability and validity of data collected for research was controlled by formulating relevant research questions while considering a research question that expresses a relationship between the variables, stating the question in unambiguous form and ensuring that the question can be tested empirically (Black 1993). The questionnaire was designed systematically and precisely to make specific content universal. The researcher carried out a pilot study to ensure validity and reliability of data collected using the questionnaire. According to Berg and Gall (1989) validity is the degree by which the sample of test items represents the content designed to be measured. To ensure validity of the study, the researcher issued questionnaires to at least two respondents in the same company at the same time then the two measures shall be compared to test reliability. The financial statement of the two questionnaires will then be correlated. According to Shanghverzy (2003), reliability refers to the consistency of measurement and is frequently assessed using the test – retest reliability method. Reliability is increased by including many similar items on a measure, by testing a diverse sample of individuals and by using uniform testing procedures.

3.7 Data Analysis

After cleaning, editing and coding, all the collected data was analyzed using qualitative approaches. To obtain these descriptive statistics, the researcher used SPSS statistical analysis software and Microsoft Excel software. Qualitative measurement tool was used to get respondents opinion away from the structured questionnaires. The study used

descriptive statistics such as frequency distribution and percentages to facilitate the change of raw data into a form that was easy to understand and interpret in relation to the study variables. Pearson correlation coefficient was used to determine the degree of association between dependent variable (quality of accounting reports) and independent variables (relevance, faithful representation, understandability, comparability and timeliness). Multiple regressions was used to establish the relationship between relevance, faithful representation, understandability, comparability and timeliness with quality of accounting reports. A multiple regression model was developed and tested to explain the relationship between the dependent and independent variables as used by other researchers like Beest, Braam and Boelens (2009), Bova and Pereira (2012) and Okpala, (2012). The model was used in establishing the level of accounting quality as the dependent variable of which the independent variable affect it. To measure the contribution of independent variable, the coefficient of determination from the model, whether positive or negative gave the relationship between the variables. The regression model below was applied to establish the relationship between the study variables:

$$QAR = \beta_0 + \beta_1R + \beta_2F + \beta_3U + \beta_4C + \beta_5T, \text{ where; } - \beta_0 = \text{Constant}$$

QAR = Quality of Accounting Reporting

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = Coefficients

R = Relevance

F= Faithful representation of reports

U= Understandability of reports

C = Coefficient for Comparability of reports

T = Timeliness of reports

Relevance was assessed by analyzing whether the reports disclose forward looking information in terms of business opportunities and risks; whether the company uses fair value as a measurement basis and whether the reports provide feedback information on how various market events and significant transactions affected the company.

Comparability testing was done to assess whether notes to changes in accounting policies explain the implications of the change; whether the notes to revisions in accounting estimates and judgements explain the implications of the revision; whether 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 study also assessed on whether the results of current accounting period are compared with the results in previous accounting periods; whether the annual report is comparable to information provided by other organizations and whether the annual report presents financial index numbers and ratios.

To assess the faithful representation variable, the study basically investigated on whether the annual reports explained the assumptions and estimates clearly; whether the annual report explained the choice of accounting principles clearly; whether the annual report highlights the positive and negative events in a balanced way when discussing the annual results; whether the annual report includes an unqualified auditor's report and whether the annual report extensively discloses information on corporate governance issues.

The timeliness of the financial reports was measured using the number of days it took the auditors to sign the auditors' report after the book year end.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter presents and discusses the analysis of data collected from various respondents who filled the questionnaires. The open ended questions generated qualitative data. The qualitative data was analyzed through the use of content analysis. Results of the data analysis provided information that formed the basis for discussion, conclusion, and interpretation of the findings and recommendations of the study.

4.2 Data Presentation

4.2.1 Responses Rate

The researcher issued seventy questionnaires to randomly selected respondents of various Small and Medium enterprises in Nairobi County. Seventy questionnaires were administered resulting to a 71% response rate. The remaining twenty questionnaires either did not have proper records of accounting or did not have official stamping and thus were unable to fill the questionnaires. The respondents were given a time frame of two weeks to enable them respond.

4.2.2 Reaction towards the introduction of IFRS

Figure 4.1 shows the reaction of the respondents when IFRS was introduced. 41.3 percent of the respondents feel that the introduction of IFRS is stressful, 34.78 percent feel indifferent about the introduction of IFRS, and 23.91 percent also feels that the introduction of IFRS is good while nobody feels bad about the introduction of IFRS. The percentage that had the feelings that IFRS is stressful is the highest percentage.

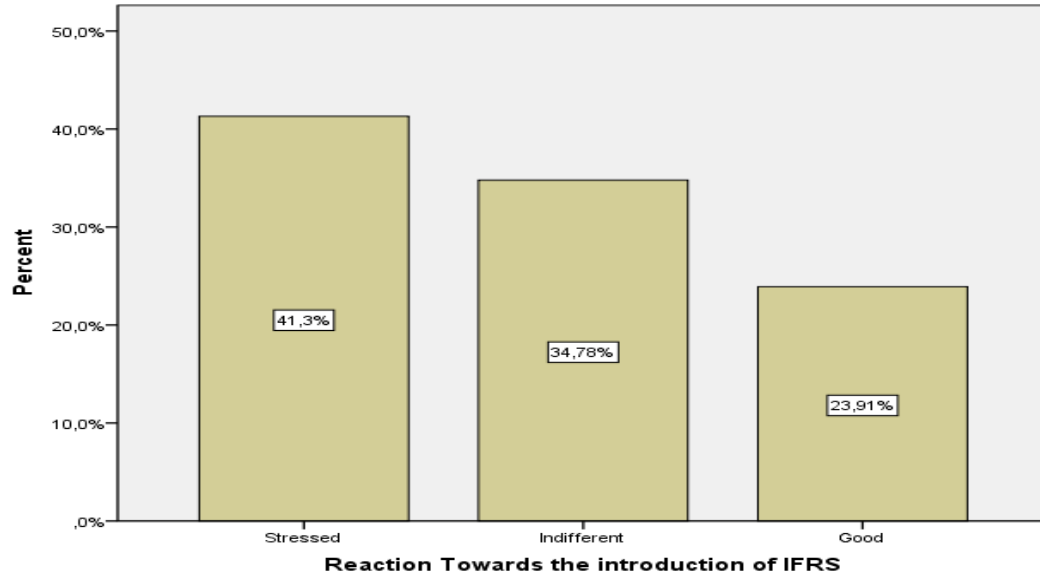


Figure 4.1: Reaction towards the introduction of IFRS

4.2.3 The difficulties encountered at the first time adoption of IFRS

Figure 4.2 shows the difficulties encountered at the first time adoption of IFRS. 10.87 percent respondents experienced training difficulty, 8.69 percent respondents say that IFRS involves high cost, 10.87 percent experienced too much of work load, 17.39 percent experienced both training difficulty and high cost, 19.57 percent experienced both high cost and too much of work load and 32.61 percent encountered the three difficulties which are training difficulty, high cost and too much of work load. The highest percentage concerning the difficulties that were encountered at the first time adoption is 32.61 percent which says that IFRS has training difficulty, high cost and too much of workloads. This means that in most cases, SMEs in Nairobi County will encounter training difficulty, high cost and too much of work load at the first time adoption of IFRS which is consistent with the “demerits of IFRS adoption in most countries” in chapter two, literature review.

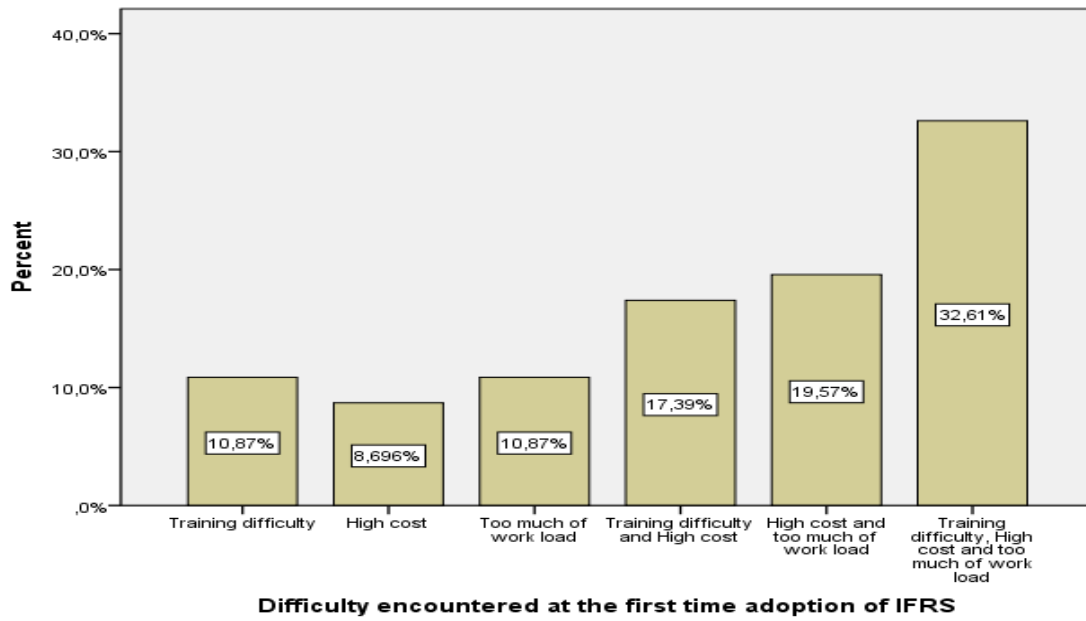


Figure 4.2: Difficulties encountered at the first time adoption of IFRS

4.2.4 Involvement in training activities when IFRS was introduced

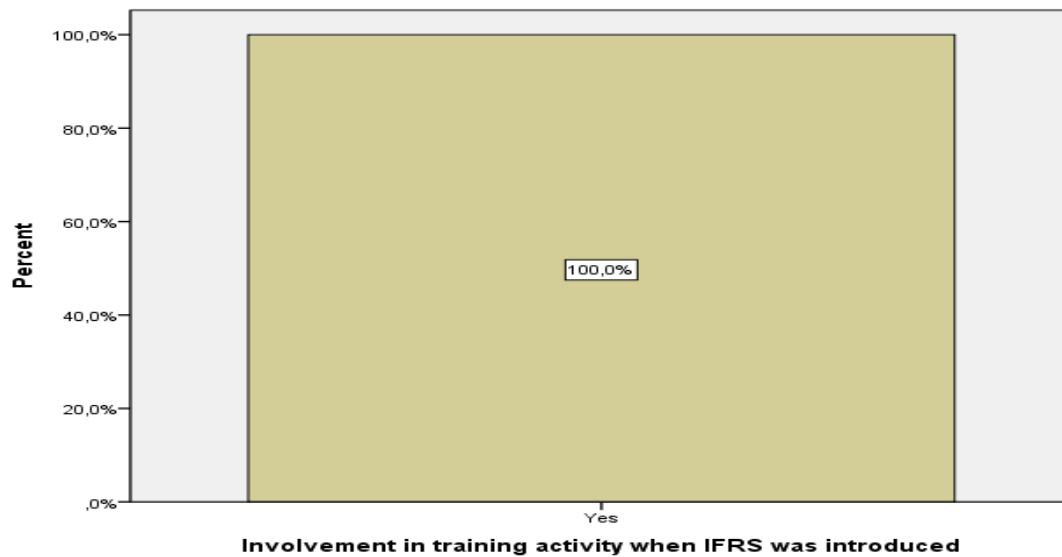


Figure 4.3 Involvement in training activity when IFRS was introduced

Figure 4.2 shows if the respondents were involved in seminar activity or not. This question was a yes or no answer. 80.43 percent of the respondents say that they were involved in seminar activities while 19.57% respondents say that they were not involved in seminar activities when IFRS was introduced. If 80 percent of the respondents could say they attended seminar when IFRS was introduced, this means it is necessary for the department members of a company that will adopt IFRS to attend seminars concerning IFRS. Figure 4.3 shows a 100 percent of the respondents say that they were involved in training activity when IFRS was introduced.

4.2.5 IFRS has affected the Kenyan - KAS

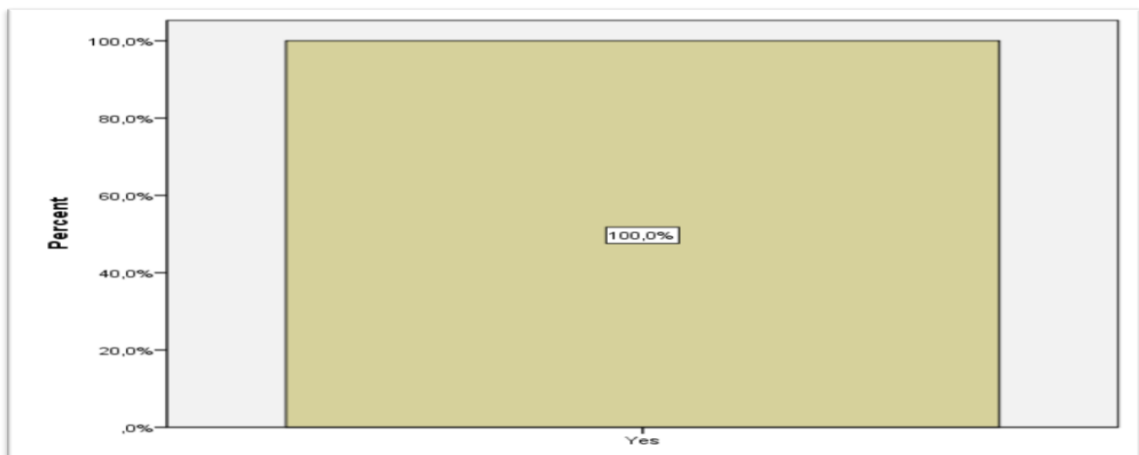


Figure 4.4: IFRS has affected the Kenyan KAS

Figure 4.4 shows if IFRS has affected the Kenyan Accounting Standards (KAS) or not. This question was a yes or no answer. All the respondents say that IFRS has affected the Kenyan KAS. If all the respondents could say that IFRS has affected the Kenyan KAS they were formally using, this means that it is true that IFRS has affected the Kenyan KAS that was formally used by most SMEs.

4.2.6 Adoption of all the IFRS 1-9

Figure 4.5 shows if all IFRS 1-9 were adopted or not. This question was a yes or no answer. All the respondents say that all IFRS 1-9 were adopted by the SMEs they work for. If all the respondents could say that they have adopted all the IFRS 1-9, this means that it is true SMEs in Nairobi County have adopted IFRS 1-9.

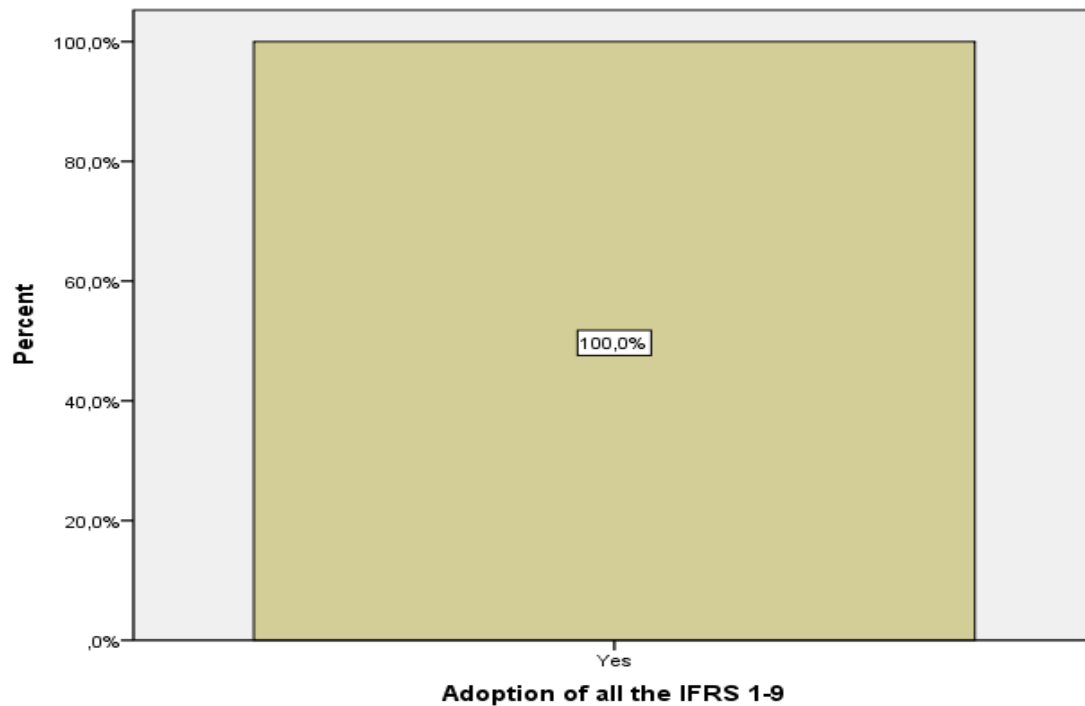


Figure 4.5: Adoption of all IFRS 1-9

4.2.7 IFRS is cumbersome

The respondents were given five answer options which are: Strongly disagree, slightly disagree, undecided, slightly agree, and strongly agree. 36.96 percent of the respondents slightly agreed that IFRS is cumbersome and 63.04 percent of the respondents strongly agreed that IFRS is cumbersome. If 36.96 percent of the respondents slightly agreed that

IFRS is cumbersome and 63.04 percent of the respondents strongly agreed that IFRS is cumbersome, that means that it is true that IFRS is cumbersome.

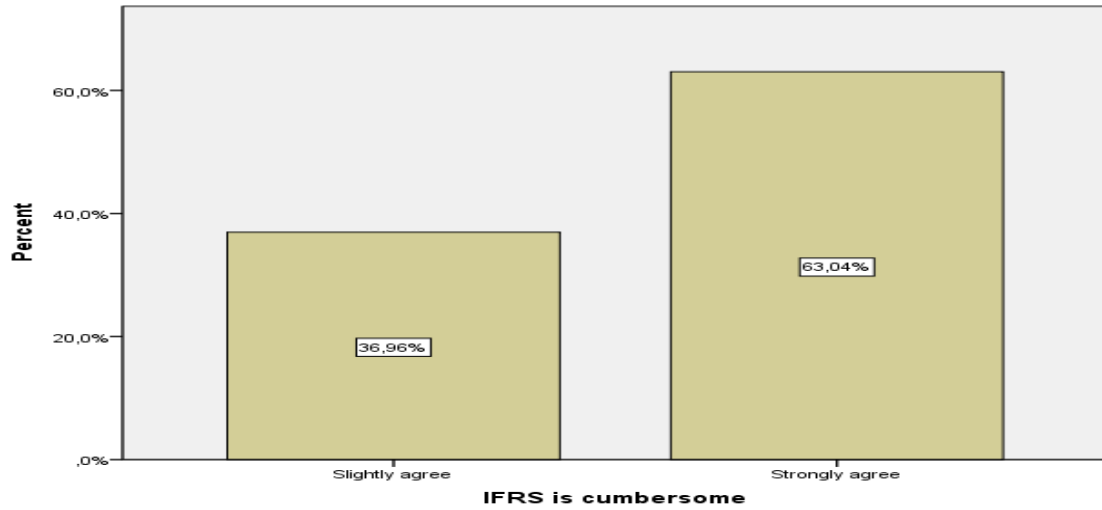


Figure 4.6: IFRS is cumbersome by SMEs

4.2.8 IFRS adoption brings about high quality financial statement

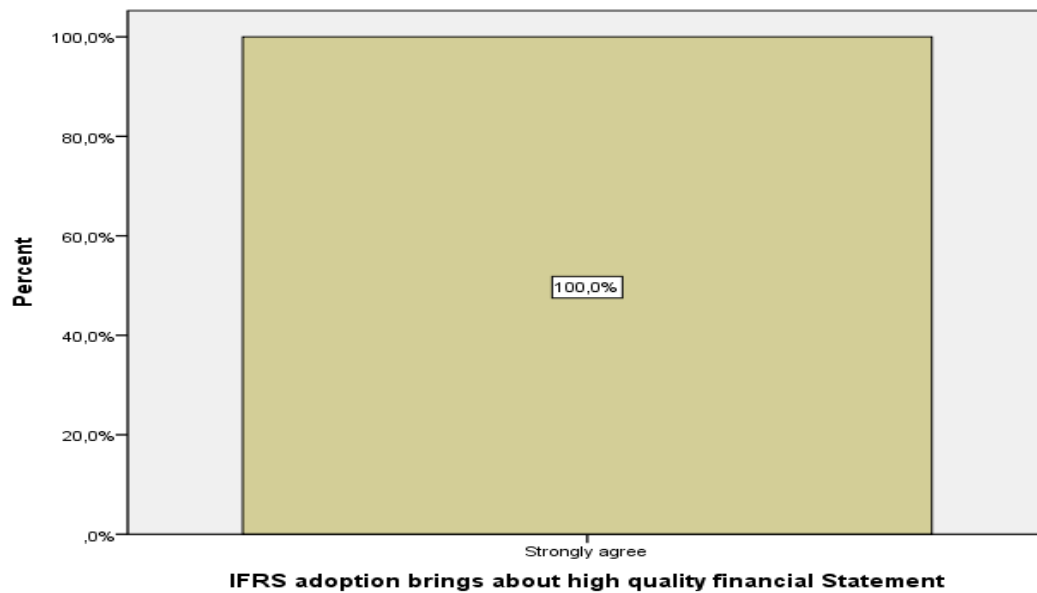


Figure 4.7: IFRS adoption brings about high quality financial statement

The respondents were given five answer options which are: Strongly disagree, slightly disagree, undecided, slightly agree, and strongly agree. All the respondents strongly agreed that IFRS adoption brings about high quality financial statement. If all the respondents could strongly agree that IFRS adoption brings about high quality financial statement, which means that it is really true that IFRS adoption brings about high quality financial statement which is consistent with the “benefits of IFRS adoption” in chapter two literature review.

4.2.9: IFRS adoption brings about transparent financial statements

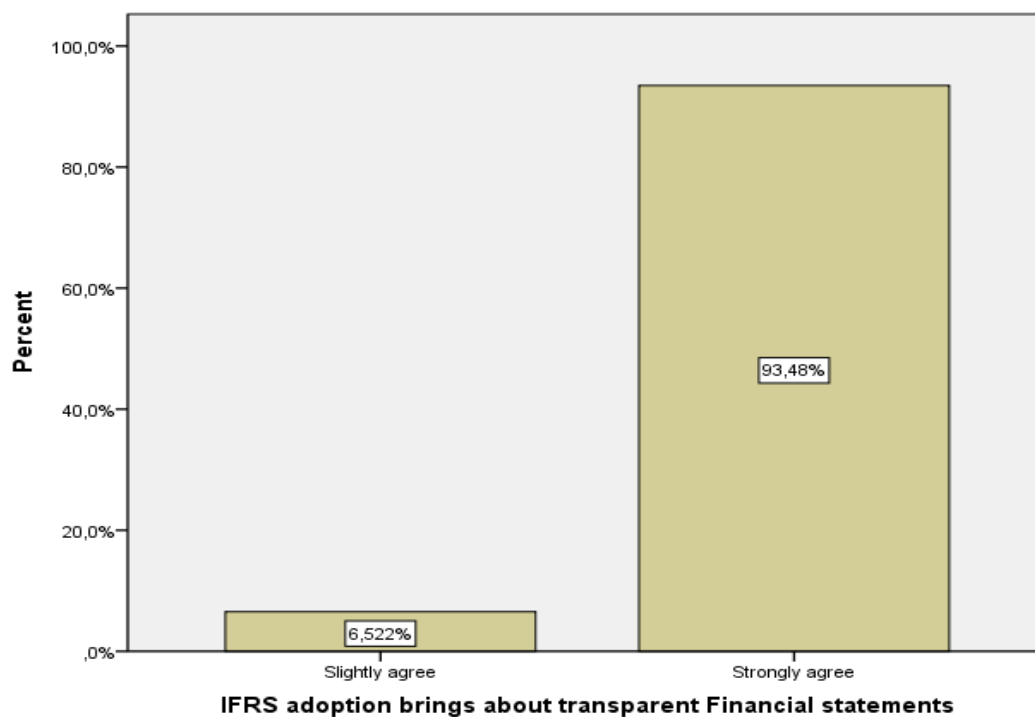


Figure 4.8: IFRS adoption brings about transparent financial statements

The respondents were given five answer options which are: Strongly disagree, slightly disagree, undecided, slightly agree, and strongly agree. 6.52 percent of the respondents slightly agreed that IFRS adoption brings about transparent financial statements and

93.48 percent strongly agreed that IFRS adoption brings about transparent financial statements. If 6.52 percent of the respondents slightly agreed that IFRS adoption brings about transparent financial statements and 93.48 percent strongly agreed that IFRS adoption brings about transparent financial statements, which means that it is true that IFRS adoption brings about transparent financial statements and it is consistent with the “benefits of IFRS adoption” in chapter two literature review.

4.2.10 IFRS brings about comparable financial statements

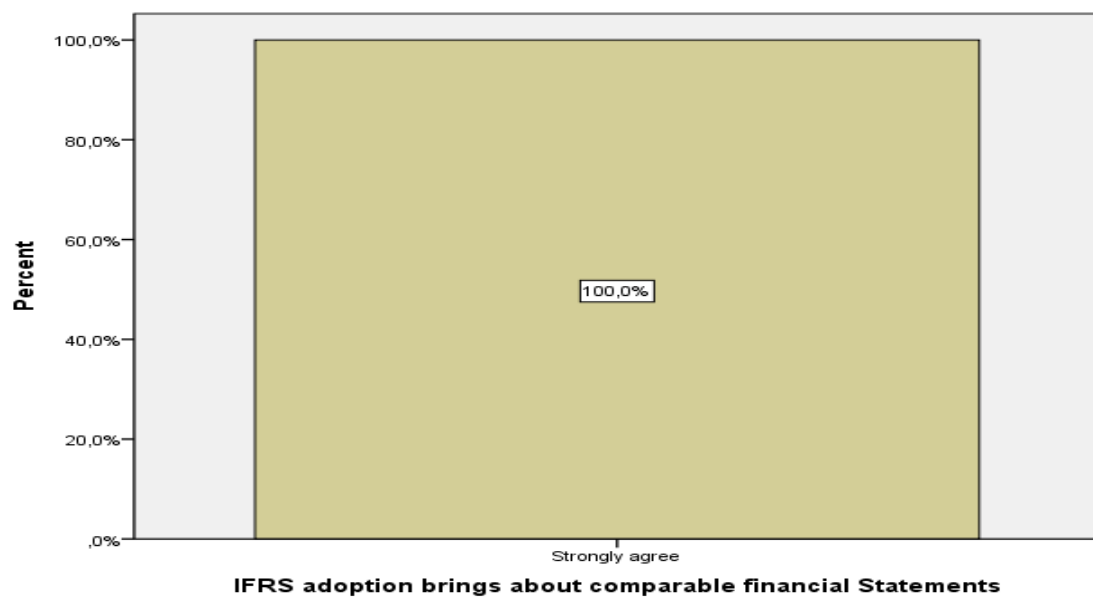


Figure 4.9: IFRS adoption brings about comparable financial statements

The respondents were given five answer options which are: Strongly disagree, slightly disagree, undecided, slightly agree, and strongly agree. All the respondents strongly agreed that IFRS adoption brings about comparable financial statements. If all the respondents strongly agreed that IFRS adoption brings about comparable financial statements, which means that it is true that IFRS adoption brings about comparable

financial statements which is consistent with the “benefits of IFRS adoption” in chapter two literature review.

4.3 Correlation Analysis

Correlation analysis is the statistical technique which is used to establish if there exists a relationship between two variables. In correlation analysis, the researcher is interested in computing the correlation coefficient which lies (-1) and (+1). A correlation coefficient of positive one (+1) means that there is a perfect positive relationship between the two variables and a correlation coefficient of negative one (-1) means is a strong negative relationship between the two variables. In this study, the researcher generated five variables (metric measure of accounting quality) using analysis in SPSS. Factor analysis is a statistical technique of reducing the dimensionality of the data while maximizing on the variation explained the generated factor scores. The generated variables were relevance, faithful representation, understandability, comparability and timeliness. In this study, the dependent variable was quality of accounting reports of SMEs while the independent variables were relevance, faithful representation, understandability, comparability and timeliness. The results of the correlations analysis are presented below:-

Table 4.1: Correlation Coefficients between Dependent Variable and Independent Variables

Variable	Correlation Coefficient (<i>p</i>)	p-value
Relevance	0.462	0.001
Faithful representation	0.582	0.000
Understandability	0.488	0.002
Comparability	0.679	0.000
Timeliness	0.514	0.001

α = (level of significance is 0.05)

The results of the correlation analysis showed that there was a positive significant relationship between the relevance and quality of accounting reports of SMEs with the application of IFRS ($p= 0.462p<0.05$). The relationship between faithful representation and quality of accounting reports of SMEs with the application of IFRS was found to be significant and positive ($p= 0.582p<0.05$). This implies that the correlation between the two variables is significant such that the adoption of IFRS enhances faithful representation of information and hence improved accounting quality reports. In addition, the results of the study showed that there was a significant positive relationship between understandability and the quality of accounting reports of SMEs with the application of IFRS. The correlation coefficient between these two variables was found to be 0.488 with an associated p-value of 0.002. According to the study, this implies that the adoption of IFRS will increase understandability of accounting procedures hence improving the quality of accounting reports in SMEs. Further, the results showed that the correlation coefficient associated with comparability is 0.679 with an associated p-value of 0.000 which implies that there is a significant relationship between comparability and the quality of accounting reports of SMEs with the application of IFRS. An increased adoption of IFRS will improve information comparability and hence increasing the quality of accounting reports by SMEs. Moreover, the study showed that timeliness in report generation is associated with the adoption of IFRS. Finally, according to the results there is a strong positive relationship between timeliness in report generation and quality of accounting reports of SMEs with the application of IFRS. The correlations coefficient associated with these two variables is 0.514 with an associated p-value of 0.000. This according to the study implies that the adoption of IFRS by SMEs will improve the

timeliness of report generating hence increasing the quality of the accounting reports effectively.

4.4 Multiple regression analysis and findings

In this subsection, multiple regression analysis was used to determine whether independent variables (RLV, FRN, UDY, CMY, and TMS) simultaneously impact the dependent variable (QAR). As a result, the subsection examines whether the multiple regression equation can be used to explain the causal theory of the effect of adopting international financial reporting standards on quality of accounting reports of small and medium enterprises.

Table 4.2 Multiple Regression Model

Model		Unstandardized Coefficient	Std. Error	Standardized Coefficient	t	Sig.
		B		Beta		
1	Constant	8.831	.936		9.436	.000
	Relevance	.907	.233	.256	3.893	.000
	Faithful representation	.570	1.693	.020	.337	.000
	Understandability	.196	.055	.305	3.590	.000
	Comparability	1.614	.303	.374	6.488	.000
	Timeliness	1.240	.299	.234	4.152	.000
Model Summary						
Model	R	R Squares	Adjusted R Squared	Std. Error of the Estimate		
1	.780	.608	.598	3.3851		
ANOVA						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2543.548	6	423.925	36.994	.000
	Residual	1638.658	53	11.459		
	Total	4182.207	69			
Predictors (Constant), Relevance, faithful representation, understandability, comparability and timeliness Dependent Variable: Quality of Accounting Reports (%)						

Quality of Accounting Reports, $QAR = 8.831 + .256R + .020F + .305U + .374C + .234T$

Table 4.2 also reports the model of quality accounting reports by SMEs. With the coefficient of determination $R^2 = 0.608$ at a significant level of $p = 0.0001$. The coefficient of determination indicated that 60.8% of the variation in quality accounting

reports by SMEs for the sample of 70 SMEs can be explained by the adoption of IFRS in the following metrics Relevance, faithful representation, understandability, comparability and timeliness while 39.2% remains unexplained. In addition, Table 4.2 reports the summary ANOVA (analysis of variance) table and F statistic, which reveals the value of F (36.994), is significant at the 0.0001 level. The value of F is large enough to conclude that the set of independent variables (RLV, FRN, UDY, CMY, and TMS) as a whole was contributing to the variance in SME quality accounting reports.

4.5 Summary and Interpretation of Findings

The study ensured seventy questionnaires were administered resulting to a 71% response rate. The remaining twenty questionnaires either did not have proper records of accounting or did not have official stamping and thus were unable to fill the questionnaires. The study measured the reaction of the respondents when IFRS was introduced. 41.3 percent of the respondents feel that the introduction of IFRS is stressful, 34.78 percent feel indifferent about the introduction of IFRS, and 23.91 percent also feels that the introduction of IFRS is good while nobody feels bad about the introduction of IFRS. The percentage that had the feelings that IFRS is stressful is the highest percentage. It was observed that all the respondents indicated that their SMEs had adopted all the IFRS 1-9, this means that it is true SMEs in Nairobi County have adopted IFRS 1-9. In terms of transparency 6.52 percent of the respondents slightly agreed that IFRS adoption brings about transparent financial statements and 93.48 percent strongly agreed that IFRS adoption brings about transparent financial statements.

The results of the correlation analysis showed that there was a positive significant relationship between the relevance and quality of accounting reports of SMEs with the application of IFRS ($p= 0.462p<0.05$). The relationship between faithful representation and quality of accounting reports of SMEs with the application of IFRS was found to be significant and positive ($p= 0.582p<0.05$). Multiple regressions indicated that adoption of IFRS provided a positive relationship between quality of accounting reports and the various independent variables. The relationship between dependent variable and independent variables, and results of testing significance of the model has been respectively interpreted. In interpreting the results of multiple regression analysis, three major elements considered were the coefficient of multiple determinations, the standard error of estimate and the regression coefficients (Emory, 1985; Davis, 1996; Lehmann, Gupta, and Steckel, 1998).

These elements and the results of multiple regression analysis were presented and interpreted in Table 4.2 above. Firstly, Table 4.2 reveals that SME quality in accounting reports (measured by relevance, faithful representation, understandability, comparability and timeliness) are significantly correlated with the correlation coefficient $R = 0.78$. The remaining step in the evaluation of the regression equation is to estimate the contribution of each independent variable in the study. Generally, all independent variables, significantly contributed in variance of the quality of accounting reports by SMEs at a significant level of 0.0001. However, the relative importance of association of each independent variable was different. This was evaluated and interpreted by the standardized coefficient of correlation (beta).

Relevance - Adoption of IFRS provided a positive relationship between quality of accounting reports and relevance of the information with $\beta = 0.256$ at a significance level of 0.0001. This finding is also consistent with Pownall and Schipper, (1999), epic on relationship between accounting standards and relevance of information to stakeholders. Those in favor of IFRS adoption also argued that the standards enhance relevance of financial statements across countries and markets which is also a component of high quality financial reporting (Pownall and Schipper, 1999). This finding is also consistent with Beest and Boelens (2009).

Faithful representation - Adoption of IFRS provided a positive relationship between quality of accounting reports and faithful representation with $\beta = 0.020$ at a significance level of 0.0001. This finding is also consistent with David Alexander and Simon Archer (2003). Faithful representation, substance over form, neutrality (freedom from bias), prudence (subject to neutrality), and completeness is mentioned as aspect of reliability (Miller International accounting standards guide by David Alexander and Simon Archer, 2003).

Understandability - Adoption of IFRS provided a positive relationship between quality of accounting reports and understandability of the information with $\beta = 0.305$ at a significance level of 0.0001. This finding is also consistent with Hung M. and Subramanyam K. (2007) in their assessment of financial statement effects of adopting international accounting standards in India. A good quality of the information in the financial statement is that the users must be able to understand it. It is also important that users of financial statement should have a good and proper knowledge concerning the business, accounting and economic activities of the business enterprise. The users of

financial statements should also be ready to read it voluntarily. (Hung M. and Subramanyam K., 2007).

Comparability – Adoption of IFRS provided a positive relationship between quality of accounting reports and comparability of the information with $\beta = 0.374$ at a significance level of 0.0001. This finding is also consistent with Jonas & Blanchet (2000).

Comparability not only refers to the consistency of the use of accounting procedures by a single company, it also refers to comparability of annual reports of different companies (IASB 2008). When assessing the comparability of annual reports of different companies, the accounting policies used, the structure of the annual report, and the explanation of transactions and other events are of special importance (Jonas & Blanchet, 2000).

Timeliness – Adoption of IFRS provided a positive relationship between quality of accounting reports and relevance of the information with $\beta = 0.234$ at a significance level of 0.0001. This finding is also consistent with Beest and Boelens (2009). Beest and Boelens (2009) assessed the quality of financial reporting in terms of the underlying fundamental qualitative characteristics i.e. verifiability and timeliness. The study findings suggested that the timeliness was an important quality effect in the guided standards adoption, fulfilling a request from both the FASB and the IASB (2008) to make the qualitative characteristics operationally measurable.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The research commenced by giving an overview concerning the need for International Financial Reporting Standards. Globalization of capital markets requires a unified global accounting, reporting and disclosure set of standards. As a result of increasing volume of cross border capital flows and the growing number of foreign direct investments via mergers and acquisitions in the globalization era, the need for the harmonization of different practices in accounting and the acceptance of worldwide standards has arisen. This worldwide standard is International financial reporting standards. Association of Small and Medium Enterprises in Kenya one of the leading association in these sector necessitates that regulators and operators in the Kenya must System take proactive steps to ensure a seamless migration to the IFRS Reporting Framework. The research further commenced by giving a general overview concerning accounting because this research topic is related to accounting field. It looked at Accounting Reports Quality and International financial reporting standards (IFRS) affect the preparation of financial statements which made the discussion about financial statements SMEs. This report discussed about the definition, objective, assumptions and elements of financial statements.

Furthermore, this report discussed about accounting professional bodies and accounting standards. This report also discussed about the International accounting professional body, accounting professional body in East Africa and accounting professional body in Kenya. Concerning the accounting standards, international accounting standards and

accounting standards in Kenya were discussed. Thereafter, the following theories were discussed, Conservative Method Theory, Liberal Methods Theory, Mixed Methods Theory, Consistent Methods Theory, Positive Accounting Theory, Regulations Theories, Public Interest Theory and Capture Theory. Chapter two was concluded by Empirical Review analysis.

The research design consists of an event study research design. The research had target population of 150 and a sample population of 70 questionnaires from the SMEs in the Nairobi County. The study used a regression analysis model to analyze the data. The study showed mixed results and that relevance, comparability, faithful representation and understandability had a positively, although weak relation to quality of the accounting reports while timeliness of signing the annual reports by auditors does not have a relationship with the change in quality of accounting reports.

5.2 Conclusion

Adopting IFRS is a very big move for the firms, accounting regulatory body and the government in Kenya because the benefits are more than the demerits as discussed earlier in this report. For every good thing introduced there are also challenges as well. The firms adopting IFRS in Kenya have made the good choice because IFRS adoption brings about transparent financial statements and this can be found in question 8. In question 7 all the respondents strongly agreed that IFRS adoption brings about high quality financial statements. In question 9 all the respondents strongly agreed that IFRS adoption brings about comparable financial statements.

Data from 70 SMEs was analyzed using the regression analysis method, from the discussion of the findings above, it can be concluded that there is a positive significant relationship between the quality of accounting reports and relevance; comparability; faithful representation and understandability of the annual accounts. These findings are not different from the results from other studies, in other parts of the world, such as Germany by Paananen and Lin (2008:26), Clarkson et al. (2009:26), Houque et al. (2010:22) and many others where they all reported that IFRS adoption does not necessarily lead to improved quality in financial reporting. Paananen. (2008:17) in a similar study in Sweden stated that IFRS adoption did not improve the quality of accounting in Sweden and went on to advise that it is dangerous to draw conclusions on using this kind of measures. These results should therefore be seen as part of the evidence vetting IFRS. Notwithstanding the outcome, these results can also be used to explain that accounting quality can improve from IFRS adoption rather than changes in managerial incentives.

Soderstom and Sun (2007:695) are cautionary and state that one cannot compare their conclusions of studies in settings where adoption is mandatory, like Kenya, to studies where adoption is voluntary or optional. They argue that accounting quality after IFRS adoption hinges on several factors such as the quality of the standards, a country's legal and political system and financial reporting incentives (financial market development, capital structure, ownership and tax system). A review of this in the Kenyan context indicated some flaws in the economic environment that hindered the success of IFRS adoption. Chen et al. (2010:272) also argue IFRS adoption would not generate accounting information with same quality across countries as other factors would affect accounting

quality. In summary, the findings are in line with many other findings where quality improvements are not conspicuous in a common law country whose domestic standards were a replica of international standards. Moreover, the fact that full compliance was not followed, in many cases, contributed to the conclusion that IFRS adoption has not significantly contributed to improvements in the quality of accounting but if all IFRS conditions were complied with then quality would improve. Broad interpretation of these results are discouraged because data collected from audited accounts generally represent what the auditors believe as the correct application of standards even if the application was compromised.

5.3 Policy Recommendations

At the moment in Kenya, IFRS is not in the syllabus of the students in tertiary institution. IFRS should be included in the syllabus of accounting student in the tertiary institutions so that students will have the knowledge before entering into the labour market.

Adoption of IFRS has contributed to improvement of quality of accounting reports. Developing systems that can enhance the use of these standards by all the SMEs will improve the reporting and presentation of accounting records in a greater. These reports will then be used as reliable documents for taxation purposes.

They government should introduce some incentives to motivate the public or entrepreneurs. This can be implemented by giving a tax waiver of a certain percentage to those SMEs who have already adopted the IFRS in full. Or alternatively, the government can even start a compulsory adoption of these standards to ensure that all SMEs adhere to the adoption. This will in a way improve the tax collected by the government, hence improving the issuance of government important services.

The government should implement compulsory adoption of IFRS, by first arranging for free public seminars introducing the IFRS to all the SMEs and the public at large. These seminars will make the SMEs understand the advantages of adopting the standards and will reduce resistance at the time of adopting them.

It is recommended that top management, external auditors and regulators being the key players in standards, need to work together and tighten compliance so that impact of IFRS could be felt more.

5.4 Limitations of the Study

The key limitation of this study was that the financial statements and reports were not available for most of the SMEs. Most of the firms Managers do not know the importance of keeping proper books of accounting.

Lack of co-operation from the management is another limitation. Most of the Entrepreneurs are not willing to give their firms' financial information as thinking that they might be misused by their competitors. Management support is very crucial for this whole process to be a success. This is contributed by lack of proper financial management skills.

Another challenge encountered during the research is lack of enough sample size to enable a researcher do a research that will generalized the whole population of SMEs. This is because most of the SMEs are not keeping their financial records according to the IFRS. The study focused on SMEs who most of them do not keep proper accounting books. Thus the sample collected was small and the results of the research cannot be generalized to the entire SME Industry.

There is also a limitation of lack of qualified staff doing the accounting work of the SMEs. This amounts to poor quality financial reports which hinder the outcome of the research. This also contributes to the resistance by the members of staff of giving out the necessary data to the researcher.

Time is also another limiting factor. The time required to collect this data is a lot due to the various limitations mentioned above. One needs a longer period of time to get data from these SMEs.

5.5 Suggestions for Further Research

The study concentrated on the effect of adopting the IFRS on the quality of accounting reports of SMEs in Nairobi County. There is need for a further study to be conducted on the effect of adoption of IFRS on the quality of reports for the Large tax Payers in Nairobi County as well. This will enable the researcher to compare the two results. Given the quantitative nature of the study, there is also a need for a study that will assess the link of the long term financial performance SMEs.

The IFRS is a broader scope of accounting which I cannot discuss everything about it in this study. This study focused on the impacts of IFRS adoption in Kenya – Nairobi County SMEs which I limited it to the multinational companies and large enterprises. However, it would be highly appropriate for further studies to be conducted on the comparison of Kenya KAS with IFRS in practical sense.

Further studies should be done on the application of the adopted standards and how well companies in Kenya apply these standards. Finally, another area of study recommendable

for further investigation would be how small and medium scale enterprises adopt and comply with IFRS in Kenya in the nearest future.

The study focused on Kenyan SME companies in Nairobi, mainly because clear records are available from them. The other areas which include public limited companies, cooperative societies, private companies and other companies which do not fall under SMEs regulators could be studied. Such a study could lead to a better conclusion on the status of the impact of IFRS adoption on the quality of accounting in Kenya and not just listed companies.

Finally another interesting area for study could be the reasons for the insignificant effect of IFRS adoption given the world wide belief that IFRS improves business performance and motivation of accountants ta the work place. Such a study could shed light on where the adoptions are not going

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APPENDIX 1

RESEARCH QUESTIONNAIRE

Kindly answer the following questions by ticking in the appropriate box or filling the spaces provided. The researcher would like to assure you that the information gathered will be kept confidential and used strictly for the purpose of this research only.

SECTION A:

1. How did you feel when IFRS was introduced?

- Bad
- Stressed
- Indifferent
- Good

Any more comments

.....
.....
.....

2. What is the difficulty you encountered at the first time adoption of IFRS?

- Training difficulty
- High cost
- Too much work of load
- Others please specify

3. Have you ever attended any seminar concerning IFRS?

- Yes
- No

4. Has IFRS really affected the Kenyan KAS you were formally using?

- Yes
- No

If yes please specify

.....
.....
.....

5. Has your company adopted all the IFRS 1-9?

- Yes
- No.

If No, please specify

.....
.....
.....

6. IFRS is difficult or cumbersome.

- Strongly disagree
- Slightly disagree
- Undecided
- Slightly agree
- Strongly agree

7. The adoption of IFRS has brought about high quality financial statements.

- Strongly disagree
- Slightly disagree
- Undecided
- Slightly agree
- Strongly agree

8. The adoption of IFRS has brought about transparent financial statements.

- Strongly disagree
- Slightly disagree
- Undecided
- Slightly agree
- Strongly agree

9. The adoption of IFRS has brought about comparable financial statements.

- Strongly disagree
- Slightly disagree
- Undecided
- Slightly agree
- Strongly agree

FOR PART B: MEASURING THE RELATIONSHIP BETWEEN THE STUDY VARIABLES:

Below, kindly tick the appropriate ranking (scale 1 = very high while scale 5 the very low)

TESTING FOR RELEVANCE

10. To what extent does relevance affects the quality of SMEs accounting reports by the adoption of IFRS?

1	2	3	4	5
Very High	High	Average	Low	Very Low

TESTING FOR FAITHFUL REPRESENTATION

11. To what extent does faithful representation affects the quality of SMEs accounting reports by the adoption of IFRS?

1	2	3	4	5
Very High	High	Average	Low	Very Low

PART E: TESTING FOR UNDERSTANDABILITY

12. To what extent does understandability affects the quality of SMEs accounting reports by the adoption of IFRS?

1	2	3	4	5
Very High	High	Average	Low	Very Low

TESTING FOR COMPARABILITY

13. To what extent does comparability affects the quality of SMEs accounting reports by the adoption of IFRS?

1	2	3	4	5
Very High	High	Average	Low	Very Low

TESTING FOR TIMELINESS

14. To what extent does timeliness affects the quality of SMEs accounting reports by the adoption of IFRS?

1	2	3	4	5
Very High	High	Average	Low	Very Low

15. In your own opinion how can SMEs improve their accounting report in the adoption of IFRS?

.....

.....

.....

.....

.....

.....

.....

THANK YOU

APPENDIX II
LIST OF SMALL AND MEDIUM ENTERPRISES (SMEs) IN NAIROBI
COUNTY

The small and medium enterprises in Nairobi County are registered at City Council of Nairobi. The registered small and medium enterprises according to the main activities conducted by businesses are as follows:

Agriculture, Forestry and Natural Resources

code	Main Activities	No. of Businesses	Category Permit fee
420	Large Mining or Natural Resources	15	80000

2. Accommodation and Catering – Code 500

503	Large High Standard Lodging House / Hotel D Class	25	100000
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3. Professional & Technical Services – Code 600

605	Large Professional Services Firm	50	90000
625	Large Financial Services	35	95000

4. INDUSTRIAL PLANTS, FACTORIES & WORKSHOPS - CODE 800

810	Large Industrial Plant	25	100000
	Totals	150	

APPENDICES III
LETTER TO THE RESPONDENTS

Jabu Abdulrazak,
P.O. Box 22664-00100,
Nairobi

Dear Respondent,
REQUEST FOR RESEARCH DATA

My name is Jabu Mabruk. I am currently studying for my Masters Degree at University of Nairobi. I am currently doing my research project to be able to complete my Course. I am specializing on accounting option and will therefore study on the impact of adopting the International Financial reporting standards (IFRS) by Small and Medium Enterprises in Nairobi County.

You have been identified as one of the people that could be of assistance with the research and thus request your participation in the research. Essentially; you will be required to complete a questionnaire. You will remain anonymous and your responses will be treated with utmost confidentiality. The information you provide will only be used for academic purposes.

Thanks in advance

Jabu Abdulrazak Mabruk

DATA SET – SPSSVARIABLE VIEW

The screenshot displays the SPSS Variable View for a dataset named 'Jabu SPSS.sav'. The main window shows a table with 15 variables (Q1 to Q15) and their properties. A 'Value Labels' dialog box is open in the foreground, showing a list of values and their corresponding labels for a selected variable.

Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure
Q1	Numeric	8	0	How did you feel when IFRS was introduced?	{1, Bad}...	None	8	Right	Scale
Q2	Numeric	8	0	What is the difficulty you encountered at the first time adoption of IFRS?	{1, Training difficulty}...	None	8	Right	Scale
Q3	Numeric	8	0	Have you ever attended any seminar concerning IFRS?	{1, YES}...	None	8	Right	Scale
Q4	Numeric	8	0	Has IFRS really affected the Kenyan KAS you were formally using?	{1, YES}...	None	8	Right	Scale
Q5	Numeric	8	0	Has your company adopted all the IFRS 1-9?	None	None	8	Right	Scale
Q6	Numeric	8	0	IFRS is difficult or cumbersome.	{1, Strongly Disagree}...	None	8	Right	Scale
Q7	Numeric	8	0	The adoption of IFRS has brought about high quality financial statements.	{1, Strongly Disagree}...	None	8	Right	Scale
Q8	Numeric	8	0	The adoption of IFRS has brought about transparent financial statements.	{1, Strongly Disagree}...	None	8	Right	Scale
Q9	Numeric	8	0	The adoption of IFRS has brought about comparable financial statements.	{1, Strongly Disagree}...	None	8	Right	Scale
Q10	Numeric	8	0	To what extent does relevance affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
Q11	Numeric	8	0	To what extent does faithful representation affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
Q12	Numeric	8	0	To what extent does understandability affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
Q13	Numeric	8	0	To what extent does comparability affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
Q14	Numeric	8	0	To what extent does timeliness affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
Q15	String	60	0	In your own opinion how can SMEs improve their accounting report in the adoption of IFRS?	None	None	28	Left	Nominal

Value	Label
1	"Training difficulty"
2	"High Cost"
3	"Too much work of load"
4	"training difficulty and high cost"
5	"High Cost and too much work load"
6	"Training difficulty, high cost and too much work load"

Jabu SPSS.sav [DataSet0] - SPSS Data Editor

File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

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12	Q12	Numeric	8	0	To what extent does understandability affects the quality of SMEs accounting reports by the adoption of I...	{1, Very High}...	None	8	Right	Scale
13	Q13	Numeric	8	0	To what extent does comparability affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
14	Q14	Numeric	8	0	To what extent does timeliness affects the quality of SMEs accounting reports by the adoption of IFRS?	{1, Very High}...	None	8	Right	Scale
15	Q15	String	60	0	In your own opinion how can SMEs improve their accounting report in the adoption of IFRS?	None	None	28	Left	Nominal
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Value Labels

Value Labels

Value:

Label:

Add

Change

Remove

1 = "Bad"

2 = "Stressed"

3 = "Indifferent"

4 = "Good"

Spelling...

OK Cancel Help

Data View Variable View

SPSS Processor is ready

*Jabu SPSS.sav [DataSet0] - SPSS Data Editor

File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

	Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure
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Value Labels

Value Labels

Value: Spelling...

Label:

Add 1 = "YES"

Change 2 = "NO"

Remove

OK Cancel Help

Data View Variable View

SPSS Processor is ready

Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure	
1	Q1	Numeric	8	0	How did you feel when IFRS was introduced?	{1, Bad}...	None	8	Right	Scale
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Value Labels

Value: Spelling...

Label:

Add Change Remove

1 = "YES"
2 = "NO"

OK Cancel Help

Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure	
2	Q2	Numeric	8	0	What is the difficulty you encountered at the first time adoption of IFRS?	{1, Training difficulty}...	None	8	Right	Scale
3	Q3	Numeric	8	0	Have you ever attended any seminar concerning IFRS?	{1, YES}...	None	8	Right	Scale
4	Q4	Numeric	8	0	Has IFRS really affected the Kenyan KAS you were formally using?	{1, YES}...	None	8	Right	Scale
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Value Labels

Value: Spelling...

Label:

Add Change Remove

1 = "Strongly Disagree"
2 = "Slightly Disagree"
3 = "Undecided"
4 = "Slightly Disagree"
5 = "Strongly Disagree"

OK Cancel Help

Jabu SPSS.sav [DataSet0] - SPSS Data Editor

File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

	Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure
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Value Labels

Value: Spelling...

Label:

Add

Change

Remove

- 1 = "Very High"
- 2 = "High"
- 3 = "Average"
- 4 = "low"
- 5 = "Very Low"

OK Cancel Help

Data View Variable View

SPSS Processor is ready

*Jabu SPSS.sav [DataSet0] - SPSS Data Editor

File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

	Name	Type	Width	Decimals	Label	Values	Missing	Columns	Align	Measure
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Value Labels

Value: Spelling...

Label:

Add 1 = "Very High"

Change 2 = "High"

Remove 3 = "Average"

4 = "low"

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OK Cancel Help

Data View Variable View

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Data View Variable View

SPSS Processor is ready

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File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

Visible: 15 of 15 Variables

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	var	
1	2	1	1	1	1	4	5	5	5	1	3	1	1	2	2	There is need for a further study to be con...	
2	2	2	1	1	1	4	5	5	5	1	4	1	2	1			
3	2	1	1	1	1	4	5	5	5	2	1	1	1	1			
4	2	3	1	1	1	4	5	5	5	1	1	2	2	1			
5	2	2	1	1	1	5	5	5	5	1	1	1	1	2			
6	2	1	1	1	1	4	5	5	5	1	2	1	1	1			
7	2	3	1	1	1	5	5	5	5	1	2	1	1	1			
8	2	3	1	1	1	4	5	5	5	1	2	2	2	1	1	Introduce IFRS in colleges	
9	3	4	1	1	1	4	5	5	5	1	2	1	1	1			
10	2	7	1	1	1	5	5	4	5	1	2	1	1	1			
11	4	4	1	1	1	5	5	5	5	1	2	1	2	2	2	2	CPA training in Kenya to recognize IFRS
12	4	4	1	1	1	4	5	5	5	2	1	1	1	1			
13	2	4	1	1	1	4	5	5	5	2	2	1	2	1			
14	2	5	1	1	1	4	5	5	5	1	1	1	2	1			
15	2	5	1	1	1	4	5	5	5	1	2	3	2	1			
16	4	4	1	1	1	5	5	5	5	1	1	1	1	1			
17	2	5	1	1	1	5	5	5	5	1	2	1	3	1			
18	3	4	1	1	1	5	5	5	5	1	1	1	1	1			
19	3	6	1	1	1	5	5	4	5	1	2	2	1	1			
20	3	5	1	1	1	5	5	5	5	1	2	5	4	1			
21	3	6	1	1	1	5	5	5	5	1	1	4	1	1			
22	2	6	1	1	1	5	5	5	5	1	1	1	1	1			
23	4	6	1	1	1	5	5	5	5	2	2	1	2	1			
24	4	3	1	1	1	5	5	5	5	2	1	1	1	3			
25	3	2	1	1	1	5	5	5	5	2	1	1	1	1			
26	3	6	1	1	1	5	5	5	5	2	2	1	1	1			
27	2	6	1	1	1	4	5	5	5	2	2	1	1	1			
28	3	6	1	1	1	4	5	5	5	2	1	1	1	5	5	More exposer by employers on the basic f...	
29	2	6	1	1	1	4	5	5	5	2	1	1	1	1			
30	2	6	1	1	1	5	5	5	5	2	1	2	2	4			
31	3	6	1	1	1	5	5	5	5	2	1	1	2	1			
32	4	6	1	1	1	5	5	5	5	2	1	1	1	1			

Data View Variable View

SPSS Processor is ready

Data View

*Jabu SPSS.sav [DataSet0] - SPSS Data Editor

File Edit View Data Transform Analyze Graphs Utilities Add-ons Window Help

1: Q1 2 Visible: 15 of 15 Variables

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	var
31	3	6	1	1	1	5	5	5	5	2	1	1	2	1		
32	4	6	1	1	1	5	5	5	5	2	1	1	1	1		
33	2	6	1	1	1	5	5	5	5	3	2	1	1	1		
34	3	6	1	1	1	5	5	5	5	2	2	1	1	4		
35	2	6	1	1	1	5	5	5	5	1	2	1	1	1		
36	2	6	1	1	1	5	5	5	5	1	2	1	1	1		
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Data View Variable View

SPSS Processor is ready

OUTPUT

```

SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav'
/COMPRESSED.
SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav' /COMPRESSED.
SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav' /COMPRESSED.
SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav' /COMPRESSED.
SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav' /COMPRESSED.
SAVE OUTFILE='C:\Users\benjamin\Desktop\Jabu SPSS.sav' /COMPRESSED.
FREQUENCIES VARIABLES=Q7
/BARChart PERCENT
/ORDER=ANALYSIS.
    
```

Frequencies

Notes

Comments		Notes
Input	Data Active Dataset Filter Weight Split File N of Rows in Working Data File	C:\Users\benjamin\Desktop\Jabu SPSS.sav DataSet0 <none> <none> <none> 36
Missing Value Handling	Definition of Missing Cases Used	User-defined missing values are treated as missing. Statistics are based on all cases with valid data.
Syntax		FREQUENCIES VARIABLES=Q7 /BARChart PERCENT /ORDER=ANALYSIS.
Resources	Processor Time Elapsed Time	00:00:00.359 00:00:00.549

[DataSet0] C:\Users\benjamin\Desktop\Jabu SPSS.sav

Statistics

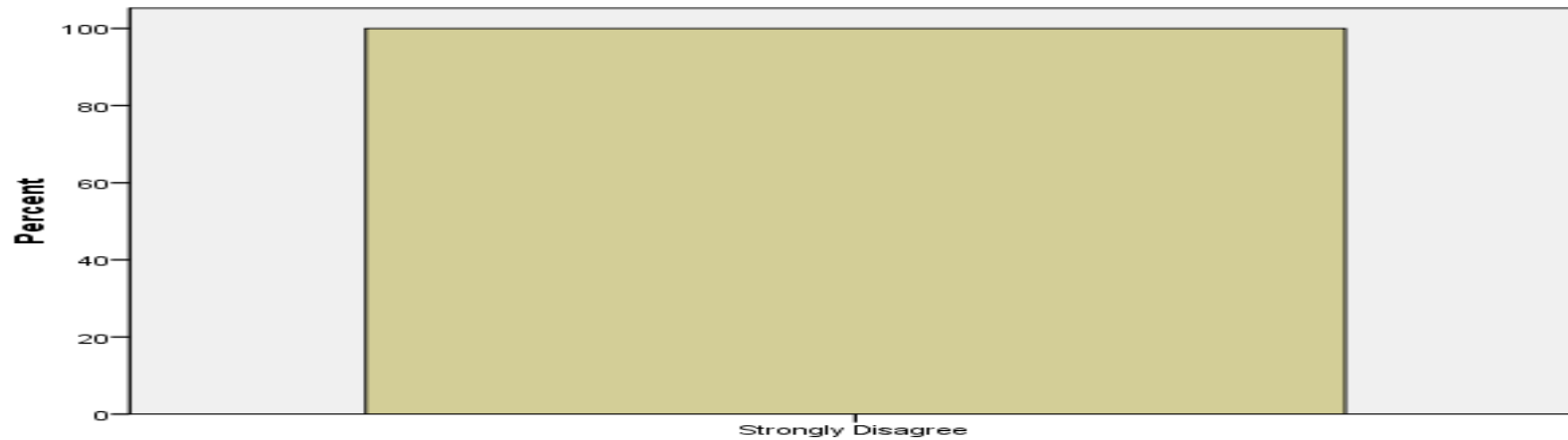
The adoption of IFRS has brought about high quality financial statements.

N	Valid	36
	Missing	0

The adoption of IFRS has brought about high quality financial statements.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	36	100.0	100.0	100.0

The adoption of IFRS has brought about high quality financial statements.



The adoption of IFRS has brought about high quality financial statements.

Statistics

IFRS is difficult or cumbersome.

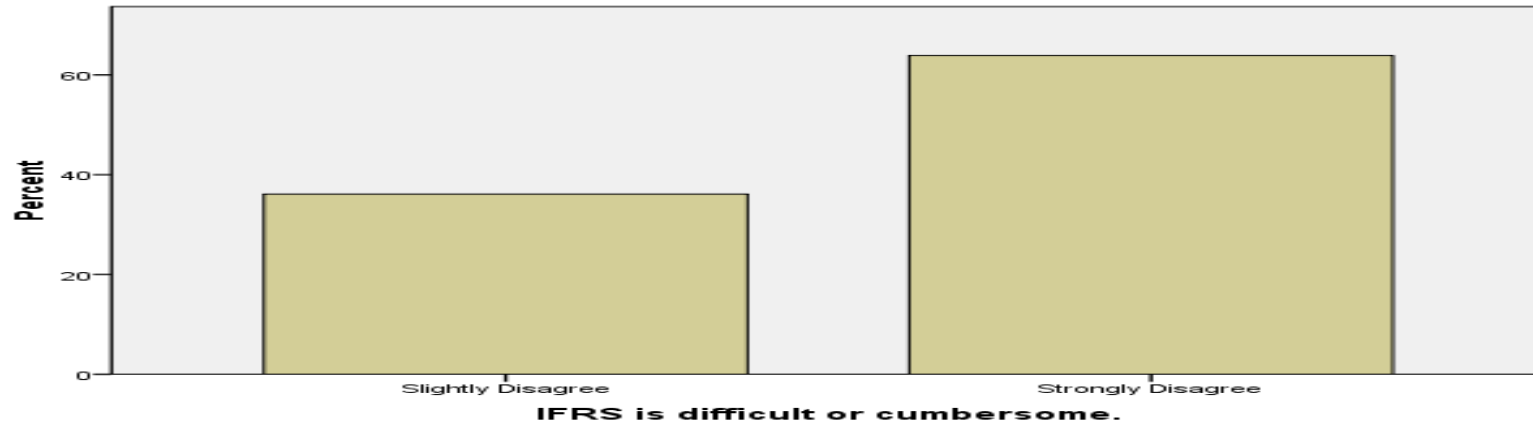
N	Valid	36
	Missing	0

[DataSet0] C:\Users\benjamin\Desktop\Jabu SPSS.sav

IFRS is difficult or cumbersome.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Slightly Disagree	13	36.1	36.96	36.96
	Strongly Disagree	23	63.9	63.04	100.0
Total		36	100.0	100.0	

IFRS is difficult or cumbersome.



Output Created			
Comments			
Input	Data	C:\Users\benjamin\Desktop\Jabu SPSS.sav	
	Active Dataset	DataSet0	
	Filter	<none>	
	Weight	<none>	
	Split File	<none>	
	N of Rows in Working Data File		36
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.	
	Cases Used	Statistics are based on all cases with valid data.	
Syntax		FREQUENCIES VARIABLES=Q6 /BARCHART PERCENT /ORDER=ANALYSIS.	
Resources	Processor Time		00:00:00.172
	Elapsed Time		00:00:00.173

```

CORRELATIONS
/VARIABLES=Q10 Q11 Q12 Q13 Q14
/PRINT=TWOTAIL NOSIG
/MISSING=PAIRWISE.

```

Correlations

Notes

Output Created			45
Comments			
Input	Data	C:\Users\benjamin\Desktop\Jabu SPSS.sav	
	Active Dataset	DataSet0	
	Filter	<none>	
	Weight	<none>	
	Split File	<none>	

Missing Value Handling	N of Rows in Working Data File Definition of Missing Cases Used	User-defined missing values are treated as missing. Statistics for each pair of variables are based on all the cases with valid data for that pair.	36
Syntax		CORRELATIONS /VARIABLES=Q10 Q11 Q12 Q13 Q14 /PRINT=TWOTAIL NOSIG /MISSING=PAIRWISE.	
Resources	Processor Time Elapsed Time		00:00:00.016 00:00:00.046

[DataSet0] C:\Users\benjamin\Desktop\Jabu SPSS.sav

Variable	Correlation Coefficient (p)	p-value
Relevance	0.462	0.001
Faithful representation	0.582	0.000
Understandability	0.488	0.002
Comparability	0.679	0.000
Timeliness	0.514	0.001