

INSTITUTIONAL INVESTORS PERCEPTION OF INFORMATION DISCLOSED IN FINANCIAL  
REPORTS OF COMPANIES LISTED IN THE NAIROBI STOCK EXCHANGE

BY

OGUTU JOHN ODIYO

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## DECLARATION

I declare that this Management research project is my original work and, to the best of my knowledge, has not been submitted to any university for a degree.

SIGNED.......... DATE.....08/11/2011.....

OGUTU JOHN ODIYO

D61/70421/2009

This MBA Research Project has been submitted for examination with my approval as the university Supervisor.

SIGNED.......... DATE.....08/11/11.....

DR. JOSIAH ADUDA

CHAIRMAN, DEPARTMENT OF FINANCE AND ACCOUNTING

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

## **DEDICATION**

Many thanks to the almighty God for seeing me through the entire period of this project. I live for you God.

Thanks to my parents for encouraging me to pursuing this project. I would not forget to thank my supervisor for his patience during the entire research period. You gave me the chance to see my best side.

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## **ABSTRACT**

The objective of this study is to investigate the perception of users regarding the level of disclosure and their confidence levels of information disclosed in the financial reports of companies listed on the Nairobi Stock Exchange (NSE). A survey methodology was utilized involving a selected sample of information users, namely the institutional investor. A total of 95 questionnaires were sent out and 45 of the respondents answered back, a response rate of about 47%.

Results of the study show that institutional investors do not highly rate the disclosure levels neither do they place high confidence in the items disclosed in the financial statements. The conclusion is that institutional investors do not perceive reported information as adequate and relevant to investment decisions. In particular, reported information was insufficient from a risk management perspective. This unfavorable perception could prevent information from being incorporated into share prices.

As the issue of level of disclosure of and confidence of different parts of the corporate annual report are concerned, the study shows that institutional investors had no full confidence in all sections contained in the financial report. Therefore, from the institutional user perception, one cannot be assertive that financial statements in their present form are regarded sufficient in formulating investment decisions. A major challenge faced was to do with perception. It is not clear the extent to which perception plays a critical role in the daily decision making process for all investors in this market. It is also not clear whether investor's behavior is based on their perception of what reality is and not on reality itself. Another challenge was getting the investors to respond to the questionnaire. A number of them were reluctant disclosing any information that expose their decision making process.

## TABLE OF CONTENTS

DECLARATION.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENTS.....	iv
ABSTRACT.....	v
TABLE OF CONTENTS.....	vi
LIST OF ABBREVIATIONS.....	viii

### CHAPTER 1: INTRODUCTION

1.1 Background of the Study.....	1
1.1.1 Investor Perception and influence on investment decisions.....	3
1.1.2 Information Contained in Financial Reports.....	3
1.1.3 The Nairobi Stock Exchange.....	5
1.1.4 Corporate Reporting and Governance in Kenya.....	5
1.1.5 Institutional Investors.....	6
1.2 Statement of the Problem.....	6
1.3 Objective of the Study.....	8
1.4 Significance of the Study.....	8

### CHAPTER 2: LITERATURE REVIEW

2.1 Introduction.....	10
2.2 Annual Reports.....	10
2.3 Accounting Principles.....	11
2.4 Principles of Periodic Disclosure by Listed Companies.....	13
2.4.1 Annual Reports should contain Audited Financial Statements.....	13
2.4.2 Management Discussions and Analysis.....	13
2.4.3 Material Related Party Transactions.....	14
2.4.4 Compensation Disclosure.....	15
2.4.5 Corporate Governance Disclosure.....	15
2.4.6 Disclosure Related to Market Risk Sensitive Instruments.....	15
2.5 Accounting Information and Capital Markets.....	16
2.5.1 Random Walk Theory.....	16
2.5.2 Positive Accounting Theory.....	16
2.5.3 Direct Perception Theory.....	17
2.6 Empirical Literature Review.....	18
2.7 Views of Users of Financial Statements.....	20
2.8 Usefulness of Financial Information.....	21
2.9 Availability of Financial Information.....	21
2.10 Adequacy of Financial Information.....	22
2.11 Conclusion.....	23

### CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction.....	25
-----------------------	----

3.2 Research Design.....	25
3.3 Population.....	25
3.4 Sample Size.....	26
3.5 Data Collection Instruments.....	26
3.6 Data Analysis and Reporting.....	27
3.7 Ethical Considerations.....	28
<b>CHAPTER 4: DATA ANALYSIS AND PRESENTATION OF FINDINGS</b>	
4.1 Introduction.....	29
4.2 Respondents Demographics.....	29
4.3 Level of Disclosure of Items in Financial Reports.....	30
4.4 Investors Confidence of Information Disclosed in Financial Statements.....	32
4.5 Summary and Interpretation of Findings.....	35
<b>CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMENDATIONS</b>	
5.1 Summary.....	37
5.2 Conclusions.....	38
5.3 Policy Implications and Recommendations.....	39
5.4 Limitations of The study.....	40
5.5 Areas for Further Research.....	40
<b>REFERENCES.....</b>	<b>42</b>
<b>APPENDIX: Questionnaire.....</b>	<b>47</b>

## **LIST OF ABBREVIATIONS**

**IASB-** International Accounting Standards Board

**IAS-** International Accounting Standards

**IFRS-** International Financial Reporting Standards

**IOSCO-** International Organization of Securities Commissions

**NSE-** Nairobi Stock Exchange



## CHAPTER ONE: INTRODUCTION

### 1.1 Background of the Study

The main users of annual financial reports are present and potential investors, employees, lenders, suppliers, customers, governments and their agencies and the general public (IASB 2009). The financial reports normally disclose the financial position, performance and cash flows of a business for a particular year which then aids the various users in ascertaining the economic value of the business and help them make investment decisions. Financial reports disclose information on: assets, liabilities, equity, income and expenses, including gains and losses, contributions by and distributions to owners and cash flows (iasplus.com, 2011). The conclusion is that information disclosure is essential for the effective operation of securities markets. Information is an important communication tool between all efficient market partners (Freedman and Stagliano, 2002). The primary objective of capital market research has been to assess whether accounting data provide value-relevant information to investors, which is incremental to all other sources of publicly available information. The information content of accounting numbers is inferred from the variability of stock prices and from changes in the volume of security trades during a short time period when these data are publicly released.

Mangena (2004) asserts that the aim of financial reporting is the dissemination of information that enables users to make informed choices. Financial information is useful in estimating the expected returns and risks of a business entity which is important before making investment decision. While International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) prescribe some standard forms of disclosure which companies have to adhere to as part of best practices, the extent of usage of such financial reports varies

across users and as such may require different levels of disclosures more than the standard level disclosures as provided in IFRS and IAS (Practicing Law Institute, 2005 p893). For example, lenders may only be interested in a business's level of debt and whether such business can meet its financial obligations. On the other hand, investors may want to know whether such business will create economic value in the future. Consequently, different users will require different levels of disclosure with the financial report.

The International Organization of Securities Commissions (IOSCO) has recognized that disclosure of reliable and timely information that is readily accessible contributes to liquid and efficient markets by enabling investors to make investment decisions based on all the information that would be material to their decisions (IOSCO, 2010).

Haslina and Mohd (1995) argue that published reports disclose accounting information that meets the information needs of unsophisticated users with limited authority, skills and expertise to access information. Financial reports should have critical information presented in a form that is of use to majority of user who are not that proficient in accounting. It is therefore important that when preparing the financial reports, the disclosure practices should be such that they meet the information needs of different users. Different users have different perceived information needs that need to be met.

Periodic reports, such as annual statements, give investors critical material facts, including financial information such as audited financial statements. Financial information is the most important disclosure in an annual report, and provides the basis of other related information that may be disclosed in the report, such as the management's assessment and analysis of the company's past performance and prospects. Additionally, in some cases, the annual report may form the foundation of a fast track system for making offerings of securities to the public. It is

of great significance that there is full disclosure provided to the secondary markets after an issuer has made an initial listing of securities. In many jurisdictions retail investors participate in the market primarily through secondary market trading rather than initial public offerings. Disclosure of high quality information to the markets on an ongoing basis is crucial after a security has been listed (IOSCO, 2010).

### **1.1.1 Investor Perception and Influence on Investment Decisions**

Perception is the process by which individuals interpret and organize sensation to produce a meaningful experience of the world. Sensation is the immediate, relatively unprocessed result of stimulation of sensory receptors in the eyes, ears, nose, tongue, or skin. Perception, on the other hand, better describes one's ultimate experience of the world and typically involves further processing of sensory input. In practice, sensation and perception are virtually impossible to separate, because they are part of one continuous process (Lindsay and Norman 1977). Perception Research provides actionable feedback from investors who have considered interest in financial statements. Investors can evaluate and perceive the information contained in annual reports in terms of availability, adequacy, and usefulness of information.

Elliot (2006) argues that perceptions on risks and corporate governance play a critical role in investment decisions. Investors will invest in organizations that are perceived to have strong corporate governance practices. Risk also plays a role in the expected rate of return. The higher the risk, the higher the expected rate of return.

### **1.1.2 Information Contained in Financial Reports**

The stock in trade in capital markets is information and how that information is disclosed. Capital market is important because it brings together users and providers of capital. Like any market, the major role of capital market is price discovery. Fair pricing of any asset ensures

optimum development of that asset for the benefit of the economy as a whole. Disclosure of all relevant facts is important to narrow the divide between the users and suppliers of capital i.e. information acts as a bridge between these two different parties (Freedman and Stagliano, 2002) and builds confidence in the capital market. With the realization that the release of relevant information to the investing public is a prerequisite to well functioning markets, there exist regulations for the preparation of financial statements to protect the investing public (Abdelkarim et al, 2009).

Financial reports meet the information needs of the other categories of users. Investors and creditors goal is to establish the capacity of a firm to generate cash in the future. However users of financial statements are made aware that such statements cannot avail all the information needed by the users to make sound decisions as they reflect past while users make decisions for the future. However, there are information needs that are general among users and it is these that the financial reports attempt to meet (IASB, 2009).

The IASB (2009) affirms that a full set of financial reports will have: a statement of financial position (balance sheet) at the end of the period; a statement of income for the period (or an income statement and a statement of comprehensive income); a statement of changes in equity for the period; a statement of cash flows for the period; and notes, explaining the accounting policies applied in the preparation of the reports. Financial reports must fairly present the financial position, financial performance and cash flows of a given business. To be fair the information must be balanced, honest and truthful representation of the effects of transactions, events, and different situations in line with the recognition for assets, liabilities, income and expenses as set out. The reliance on IFRSs in compiling annual reports is intended to result in financial statements that achieve a fair presentation.

### **1.1.3 The Nairobi Stock Exchange**

The Nairobi Stock Exchange was established in 1954 (Kibuthu 2005). At that time NSE was as a voluntary association of stockbrokers constituted under the Societies Act. Africans and Asians were not allowed to participate in the activities of the bourse during this period. Trading at the NSE was only open to Europeans until the attainment of independence in 1963. The bourse had about 10 listed companies at that point.

The main products at the NSE are shares and bonds. At the moment, there are over 50 different types of shares and over 60 bonds listed at the NSE. NSE facilitates the mobilization of capital for growth and provides Kenyans with a platform to invest their earnings and in so doing encourage savings. Funds that would have been deposited in banks are channeled to productive sectors of the economy through the NSE. This stimulates economic growth as savings for investments are mobilized (NSE, n.d). Therefore NSE provides a platform for a study such as this.

### **1.1.4 Corporate Reporting and Governance in Kenya**

It is appropriate to provide a brief overview of the regulatory framework in Kenya with respect to corporate financial reporting. Like most Commonwealth countries, the Kenyan Companies Act (Chapter 486, Laws of Kenya), is based on and is largely the same as the UK Companies Act of 1948 (Ogola, 2000). The Kenyan Companies Act sets the general framework for financial accounting and reporting requirement for companies in Kenya. The Sixth Schedule of the Act sets out the disclosure requirements for the balance sheet and the profit and loss account. Corporate governance has gained prominence in Kenya and therefore the need to improve on the quality of information contained in annual reports.

### **1.1.5 Institutional Investors**

From Wikipedia, the free encyclopedia, institutional investors are organizations which pool large sums of money and invest those sums in securities, real property and other investment assets. They can also include operating companies which decide to invest their profits to some degree in these types of assets. In this study investors include banks, insurance companies, retirement or pension funds, hedge funds, investment advisors and mutual funds. They act as highly specialized investors on behalf of others. For example in the case of pension, he employer gives employee pension contributions to a fund. The fund then invests the amount in shares or other financial assets. This explains why institutional investors source information from annual reports.

### **1.2 Statement of the Problem**

Since the study of Ball and Brown (1968) the usefulness of information contained in annual report has been one of the most important research areas in accounting. Accounting literature documents the usefulness of accounting earnings, book value and other items in the financial reports (Graham and King 2000, Chen 2001). However there are studies that report a decreasing trend in the relevance of financial statement information (Francis and Schipper, 1999).

The basis of this study is that information disclosure is vital for the efficient operation of capital markets like Nairobi Stock Exchange. The primary concern of suppliers of information to capital market is to provide value-relevant information to investors. Insufficiency of information contained in annual report as a result of weaknesses of regulations and disclosure requirements lead to pruned information that fail to meet the expectations of the users. This

impedes the flow of funds to firms with worthwhile projects thus harming the economy as a whole.

One source of information that flow into the capital market is found in annual reports. But the information contained in annual reports must be incremental to other publicly available information, if it is to be useful i.e. annual reports is not the only source of information. Research in capital markets assess the usefulness of accounting information by estimating the reaction of investors at the capital market, whenever there is release of accounting information (Ball and Brown 1968). The assumption is that financial information contained in annual reports influence the price and volume of securities traded at the stock market. If that assumption holds then the next logical step is to establish how investors asses risk at to enable suppliers of information provide information that can aid investors in assessing risk (Schrand and Elliott 1998). Therefore, as a step to increasing the value of information, it is important finding out from investors the shortcomings of information contained in annual reports. This study will seek to establish whether the information is available, adequate, and useful. This is because if investors are to make sound decisions about the value of securities, they must have relevant facts.

A research done on "Investor Perception of Information Disclosed in Financial Reports of Palestine Securities Exchange Listed Companies" indicates that users perceive reported information as neither adequate nor relevant to investment decisions. In particular, reported information was insufficient, as listed companies did not comply with the minimum disclosure requirements of international standards. This unfavorable perception, along with poor credibility and bad timeliness of the disclosures, has prevented information from being impounded into stock prices. The study presented a number of recommendations that may be

helpful in improving the efficiency of the PSE, which in turn will contribute to the Palestinian economy as a whole (Abdelkarim, Shahin, & Arqawi, (2009).

There exists a research gap on the level of disclosure of financial reports of companies listed at the Nairobi stock exchange and the users perception on the information contained in the statements. A gap exists on the extent to which the investors rely on the financial statements to make investment decisions based on the information contained in these statements. The researcher will thus seek to fill this research gap.

The researcher in seeking to examine institutional investors perception of information disclosed in financial reports of companies listed at The Nairobi Stock Exchange will ask the following questions; what is the level of disclosure of financial reports of companies listed at the NSE?, what is the reaction or confidence on the information provided in the financial reports by institutional investors?

### **1.3 Objective of the Study**

The primary objective of this study is to determine the perceived investor usefulness of information contained in financial reports for firms listed in the Nairobi Stock Exchange.

### **1.4 Significance of the Study**

Through the study, information will be availed on the importance of various items in the financial reports which will lead to more disclosure of such items in the financial reports.

### **Regulators, Financial Analyst, Brokers, Investors**

This study would be of value to regulators, financial analyst, brokers, investors, and researchers especially in developing and emerging markets. Different investors have different information needs. Since information disclosure is essential for the effective operation of the capital



markets, the regulators are increasingly concerned about the quality of information contained in annual reports.

### **Researchers and Students**

The results of this study will also be of use to other researchers and students seeking information on the perception of the financial statements by investors at the NSE.

### **Management**

The findings of this study will be of use to the management of the listed companies as they will find the information useful as it could guide their companies when preparing financial statements to meet the needs of various stakeholders.

### **Accountants and Nairobi Stock Exchange**

Accountants will also benefit from the study as it will show how investors perceive items in financial statements hence work towards providing high quality information to the users of financial statements. And also the Nairobi Stock Exchange will be able to see whether it is necessary to adjust their guidelines concerning disclosure requirements.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter will review literature on annual financial reports, the types, accounting principles employed in preparation of the reports and the characteristics of good financial reports and value of annual report to capital markets.

### **2.2 Annual Reports**

According to the IASB (2009) the main purpose of IAS 1 is to provide the basis for presentation of general financial statements, to ease comparative analysis with earlier periods and other businesses. The requirements for presentation of financial reports are highlighted in IAS 1 which also deals with recognition and disclosure of items in financial reports. IAS 1 is applied to all general purpose financial statements based on International Financial Reporting Standards. General purpose financial statements are described as those prepared for an audience that cannot request for financial reports that are customized to meet their information needs (Elliot, 2006).

Elliot (2006) observes that the goal of general purpose financial statements is to disseminate information regarding the financial state, financial performance, and cash movements that is of use to several stakeholders. The financial reports provide information on: assets; liabilities; equity; income and expenses; contributions by and distributions to owners; and cash movements. A set of financial statements that is full should have: a statement of financial position (balance sheet) at the end of the period; a statement of comprehensive income for the period (or an income statement and a statement of comprehensive income); a statement of

changes in equity for the period; a statement of cash flows for the period; notes, comprising a summary of accounting policies and other explanatory notes (IASB, 2009).

The Manitoba local government (2009) contends that elements of financial statements are basic types of items captured in financial reports. There are two basic types of elements: those that capture the economic resources available (i.e. balance sheet, assets and liabilities), and those that show changes in economic resources over a period of time (i.e. income statement, revenues and expenses). The notes to financial statements, which are used in provision of further clarifications, are not considered to be an element of financial statements. The elements of government financial statements include: assets (financial Assets & non-financial Assets), liabilities, revenues and expenses.

Financial reports are based on an asset and liability model. Revenues and expenses are expressed in terms of increases or decreases in assets and liabilities. Operating results for an accounting period can only result from changes in assets and liabilities. If an item does not meet the definition of either an asset or a liability, then it cannot be included as a balance in the financial statements (Manitoba local government, 2009).

### **2.3 Accounting Principles**

Financial reports must "present fairly" the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation (IASB, 2009).

The IASB (2009) points out that a business whose financial statements comply with IFRSs must make an open and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.

Any businesses presenting IFRS financial statements are presumed to be a going concern. If management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures (IASB, 2009).

IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accrual basis of accounting. For consistency purpose, the presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS.

Each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial (IASB, 2009).

IAS 1 requires that comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements, both face of financial statements and notes, unless another standard requires otherwise.

## **2.4 Principles of Periodic Disclosure by Listed Companies**

### **2.4.1 Annual Reports should contain Audited Financial Statements**

IOSCO (2010) notes that the information provided in the annual report should be as of the latest practicable date, except where the applicable law or regulation requires the information to be provided for the financial year covered by the report or as of a specified date. At a minimum, listed companies should be required to provide audited financial statements that cover the entire prior financial year in their annual reports. The audit report must be given by an independent audit firm that is subject to oversight by a body that acts and is seen to act in the public interest. Current security holders, as well as potential investors, need information about the issuer's financial position, performance and cash flows in order to assess its liquidity and solvency and in order to make informed decisions about their investment strategy with respect to the issuer's securities. The issuer's financial statements are an important source of this information. Accurate and reliable publicly available financial information enhances investors' confidence in the public markets.

### **2.4.2 Management Discussion and Analysis (MD&A)**

In addition to their audited financial statements, listed companies should provide in their annual reports an MD&A discussion. Through this discussion, management explains the factors that have affected the company's financial condition and results of operations for the historical periods covered by the financial statements, as well as management's assessment of the factors and trends that are anticipated to have a material effect on the company's financial condition and results of operations in the future. MD&A enables investors to see the company through the eyes of management and improves the financial disclosure by providing the context within

which financial statements should be analyzed. OFR/MD&A provides a balanced explanation by management of factors that have affected the issuer's financial condition and results of operations for the periods covered by the financial statements included in the annual report. This disclosure provides a context within which the financial results and financial position portrayed in the financial statements can be interpreted, and enables investors to see the issuer through the eyes of management. It may provide information about the quality and potential variability of the issuer's earnings and cash flow. As a result, investors are in a position to have a better understanding of the issuer's financial position (IOSCO, 2010).

### **2.4.3 Material Related Party Transactions**

Disclosure about material related party transactions is important to investors because it helps provide a materially complete picture of the issuer's financial relationships and identifies potential conflicts of interest. Related parties include, among others, the issuer's Directors and Senior Management, any nominees for Director, beneficial holders of a significant amount of the issuer's securities and the immediate family members of all of these persons, as well as affiliates of the issuer. Related party disclosure usually includes items such as the nature of the relationships, description of the transaction, business purpose and amount of transactions entered into by the issuer with related parties. In some jurisdictions, this disclosure also includes information about the issuer's policies and procedures for the review, approval or ratification of transactions with related parties, such as whether a special committee is responsible for approving these transactions (IOSCO, 2010).

#### **2.4.4 Compensation Disclosure**

Information about Director and Senior Management compensation and risk management practices is important to investors so that they can assess the incentives created by this use of the issuer's resources, whether the incentives of the compensation are aligned with investors' interests, and how performance may be oriented to the returns generated for shareholders (IOSCO, 2010).

#### **2.4.5 Corporate Governance Disclosure**

An issuer's good corporate governance practices can improve investor confidence that effective controls exist within the company, that the Directors and executive officers are held accountable for their actions, and that shareholders will be able to exercise their rights. Adequate disclosure helps investors assess an issuer's corporate governance practices. Although some countries require companies to comply with certain corporate governance laws or regulations, others recommend that certain corporate governance codes be followed by requiring issuers to either comply with these codes, or to explain why the codes are not being complied with

#### **2.4.6 Disclosure Related to Market Risk Sensitive Instruments**

Disclosure of the issuer's exposures to market risk associated with activities in derivative financial instruments (e.g., futures, forwards, swaps, and options), other financial instruments (e.g., investments, loans, structured notes, mortgage backed securities), and derivative commodity instruments (e.g., commodity futures, commodity swaps) enable investors to more accurately assess the primary risk of loss to the issuer. Market risk includes interest rate risk, foreign currency exchange rate risk, commodity price risk, and liquidity risk among other

things. This disclosure is particularly relevant to investors in light of the sophisticated financial instruments that many public companies are increasingly relying on both to boost profitability and to hedge against risk.

## **2.5 Accounting Information and Capital Markets**

### **2.5.1 Random Walk Theory**

The random walk hypothesis is a financial theory states that stock prices are determined randomly without a systematic way hence making it difficult to project them accurately. Several tests have been done to prove the theory. The theory was postulated by Paul Cootner in 1964. The theory asserts that share prices are unpredictable, especially in the short term. The reason why prices follow a random walk is because information arrives in a random fashion. This implies that fundamental analysis and technical analysis cannot be used to predict share prices and that it is impossible to outperform the stock market (Malkiel, 1973).

### **2.5.2 Positive Accounting Theory**

Accounting affects people's behaviour and people affect accounting. Positive accounting looks at managers' accounting policy choices, as part of the overall process of corporate governance. It states that accounting policies are selected strategically and tries to understand and predict managers accounting policy choices (Ball and Brown 1968). Bartlett & Chandler (1997) argue that an organization is a nexus of contracts. Managers are considered to be rational in their decision making process acting to maximize their utility and not necessarily the returns for the organization. They could be lethargic and unproductive. In the open market, there are efficient markets for both capital and managerial labour.



There are three hypotheses to the positive accounting theory that influence the usefulness of financial information: i) Bonus Plan Hypothesis-management selects accounting policies to shift future earnings to current period (more rewards from managerial incentive contracts); ii) Debt Covenant Hypothesis-policies are selected to shift future earnings to present to avoid violation of debt contracts; and iii) Political Cost Hypothesis- deference of earnings from current to future to minimize political "heat." Reported earnings can be controlled through: changing accounting policies; managing discretionary accruals; timing of adoption of new accounting standards; changing real variables--R&D, advertising, repairs & maintenance; structured transactions; and fraud through capitalizing operating expenses. The positive accounting theory can be: i) opportunistic when managers choose accounting policies to benefit them; or ii) efficient contracting where managers select accounting policies to attain corporate governance objectives of the firm (Bartlett and Chandler, 1997).

### **2.5.3 Direct Perception Theory**

Gibson (1950) argues that direct perception is the use of environmental cues to generate a percept (bottom-up processing only). In contrast, the cue theory uses both bottom-up and top-down (unconscious inference) to construct percepts. There are three principles of direct perception. The first principle states that the environment contains all of the sensory information needed to form an accurate perception. The environmental cues for distance and depth, are referred to as "texture gradients". The second principle of direct perception states that perception is immediate and spontaneous; therefore, it does not use any unconscious inference. This principle is illustrated by the "walking lights" experiment. When the body is not moving, it is impossible for the observer to distinguish any shape. However, the second

(actually, the 1/4sec) that the lighted individual starts to move, the observer knows exactly what he/she is looking at.

Gibson (1950) further adds that the third principle of direct perception states that perception and action are inextricably linked. This means that perception is used to guide action, and this action provides additional cues to be processed by the perceptual system, and this in turn provides more guidance for the ongoing movement.

Perception plays a critical role in the daily decision making process for all investors. Investors behavior is based on their perception of what reality is, not on reality itself.

## **2.6 Empirical Literature Review**

Al-Mubarak (1997) confirms that the annual corporate report is the primary source of corporate information. Abdelsalam (1990) find that investors read the annual reports, with a lot of emphasis on income statement. Al-Gareh (2001) tested empirically the PSE daily price index by using multivariate methodology and found out that the market is weakly efficient. Al-Fayyumi (2003) tested the informational efficiency by analyzing the relationship between trading volume and stock-price volatility and found that the price volatility is not explained directly by the flow of information, and that mixture of distributions hypothesis (MDH) is not irrelevant. Fayyumi (2003) results prove that investors should pay more attention to the fundamental (financial) information in order to improve the rationality of the decision making process. Fayyumi (2003) conclude that market inefficiency and corporate governance undermine the development of capital market because of their negative impact on depth, liquidity, volatility, and trading volume at the security market (Jafary and Makhool, 2004).

According to Baker and Wallage (2000,) 'financial reporting consists of those customary and legally required reports that managing directors of companies provide to shareholders and other interested parties'. However, there may be a gap between the legal (accepted based on laws and rules) and what is actually followed as financial reporting model. The legal financial reporting model may not fully reflect the actual financial reporting system in use. This implies that the users may consult with other sources of information, which may not be considered by the legal financial reporting model.

Ashbaugh, Johnstone and Warfield (1999) examination of the application of internet as a support to external reporting found that firms' websites provides more timely financial information and in some cases, more financial and nonfinancial data than traditional paper-based reporting method. Moreover, Frost and Pownall (1996) found that large multinational companies, sophisticated financial analysts and portfolio managers who follow them, operate mostly in an environment where audited financial statements are not directly relevant to their decision-making process. For example, institutional investors may broadly rely on financial analysts for information concerning potential investments (Byrne, 1998). Furthermore, financial analysts and other information providers use on-line and real time information that enables them to have updated information immediately (Baker and Wallage, 2000).

Financial analysts apply unaudited earnings forecasts by management to revise their own earnings forecasts, which may in turn become a primary source of information for investors' decision making (Williams, 1996). Searching other alternatives to authenticate information is the reason that the role of the financial analysts and other information providers is becoming increasingly important (Baker and Wallage, 2000). Financial analysts not only use information

provided by corporate managers but also are information providers to other users particularly investors and creditors.

Financial analysts gain valuable insights about the current performance and future prospects of a firm when they analysis a firm (Palepu, Bernard, and Healy, 1996). They are the most important information mediators between firms and investors that usually collect and process a vast amount of information from corporate insiders and subsequently distribute this information to current and potential investors. An analyst's report is the end of a process that includes the collection, evaluation, and distribution of information related to a firm's future performance (Smith, 1992). In fact, many investors rely on the information provided by financial analysts when they do portfolio selections and revisions (Chung and Jo, 1996). The financial analysts as information mediators increase the investors' knowledge about the factors that can influence share prices such as company's performance (Kuperman, Athavale, and Eisner, 2003)

## **2.7 Views of User of Financial Statements**

Abu-Nassar and Rutherford (1996) undertook a study to discover the view of external users of annual corporate reports. They targeted different groups of external users, namely individual shareholders, institutional shareholders, bank loan officers, stockbrokers, and academics. They found out that bank loan officers were the heaviest users of the annual reports in Jordan, while individual shareholders and academics were found to be the least. They also found the income statement and balance sheet to be the most widely read parts of the annual corporate report by all users.

## **2.8 Usefulness of Financial Information**

From Beaver (1981) we learn that “Financial reporting should provide information that is useful to present and potential investors and creditors and other users in assessing the amounts, timing and uncertainty of prospective cash receipts. Since investors’ and creditors’ cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors and others assess the amounts, timing and uncertainty of prospective net cash inflows to the related enterprise”. Financial reporting usefulness has been one of the most important research areas in accounting. Since the seminal study of Ball and Brown (1968), extant accounting literature has well documented the usefulness of accounting earnings, book value and other items in the financial reports (Graham and King , 2000); Chen , 2001). While most of these studies provide evidence that annual report is an important source of information, they report low association between accounting numbers and stock prices or returns. Some recent studies even report a decreasing trend in the value-relevance of financial statement information (Francis and Schipper, 1999).

Researchers empirically establish the usefulness of financial reports or other financial information by the statistical association between the financial information and stock prices or returns. However a survey-based research complement the archival-based research in that it gathers data on a multitude of individual beliefs and practices to provide the underlying reasons for investors’ behavior and therefore employed

## **2.9 Availability of Financial Information**

Information is timely when it is available to users early enough to allow its use in the decision process. Information that reaches decision maker after the decision is of limited use. The need

for timely information requires that companies provide information to external users on a periodic basis. Timely disclosure of accurate information by the reporting entity on important matters is critical to protecting shareholders' rights. This is because shareholders need to make decisions that are in their interest and that information disclosure is crucial in preventing managers and dominant shareholders from engaging in activities that are detrimental to other stakeholders. The confidence with which users rely on information in financial statements is reinforced through an audit by certified public accountants. An audit is a vital aspect of good accounting information especially where investment decision are based on such information.

## **2.10 Adequacy of Financial Information**

Adequacy of information contained in financial statements become an issue because the incentives of management with respect to financial reporting is an open issue i.e. management have a discretion on the content of annual reports.

Beaver (1981) tell us that a prominent feature of financial reporting environment is the regulation of the flow of financial information to investors and that the regulators can influence financial reporting environment. This regulation is motivated by concern over the welfare of investors, the fairness of the security markets, and prevention of perceived adversities and inequities that may befall investors due to informational deficiencies, such as failure to disclose material information (Beaver, 1981). Despite all the regulation the ultimate test is whether the users of financial information consider the information supplied adequate and this can be determined by asking them.

The information should be relevant to the decision-making users of the information. Relevant information makes a difference in their decisions and requires that the information has both

feedback and predictive values. For example, if information in the income statement confirm investor expectations about a firm's future cash-generating ability, then that information in the income statement has feedback value for investors. The same information, after confirmation, can be useful in predicting future cash-generating ability as expectations are revised.

The idea that financial statements must be presented in a manner that conforms to generally accepted accounting principles includes adequate disclosure of material matters. The concept of adequate disclosure relates to the form, arrangement, and content of the financial statements and their appended notes, including the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

## **2.11 Conclusion**

The main expected role of the financial reporting is to meet the external users' varying needs. Users of financial reports in general and particularly investors require useful information for their decision making. Over the time, changes in the needs impel changes in the types of information required and the dissemination of such information, i.e. financial reporting (Salvary, 1998). It seems that recent changes in the users' needs are too fast for financial reporting to cope, which may result in the users' dissatisfaction. Therefore, the users may seek other sources of information. Traditional financial reporting provides specific type of information, i.e., financial information in a specific format while nowadays users decide individually on the type of information that is important to them (Behets, 1998) as well as its proper format (Baker and Wallage, 2000).

Although providing audited financial statements are required by the law and accounting standards, global capital markets may not rely on this type of traditional financial reports as

they may not be directly relevant to their decision making process (Frost and Pownall, 1996). Investors need information on real time but financial statements are provided a few times to users. This delay may not be accepted as global decision making requires real time and on-line information. This may encourage investors to seek other sources of information such as firms' websites, financial analysts' forecasts, unaudited interim earnings' announcements, and privately obtained information for investment decision-making (Williams, 1996). As a result, financial reporting process may be affected by new players in the market (e.g., financial analysts and advances in information technology), which may have not been considered in the traditional (legal) financial reporting model. All of this may result in a gap between legal and actual financial reporting models. This gap may be bigger in developing countries such as Kenya in which the legal reporting system is mainly affected by external factors. This study is therefore different from the empirical studies done in that it will mainly aim at finding out what specific variables in the financial statements that investors and other external users of financial statements find relevant in their decision making process. It is also aimed at finding out what investors need to be adjusted in the disclosure requirement by the regulator.



## **CHAPTER THREE: METHODOLOGY**

### **3.1 Introduction**

In this chapter the methodology to be used in the study is presented. The chapter is divided into two sections: The first section one presents research design. This is followed by a discussion of the data collection procedure and data analysis.

### **3.2 Research Design**

Kathari (2002) asserts that a research design refers to the way the study is designed, that is, the method used to carry out a research. A research design can be defined as a survey-based research. The study will apply a descriptive research design. Kisilu and Tromp (2006) affirm that the main aim of descriptive research is to clearly describe the state of a given phenomenon as it is with the researcher tabling the findings. This type of research shows the characteristics of a given individual or group.

Qualitative statistics are known to be strong on validity though weak in reliability (Mugenda and Mugenda, 1999). They provide information on the understanding of human behaviour and its motivation. Quantitative data shows quantitative properties and relationships. Under this, investors in listed companies at the Nairobi Stock Exchange will be asked to evaluate the usefulness of information contained in the annual reports.

### **3.3 Population**

Kisilu and Tromp (2006) define a population as a group of objects which provides the sample that is studied. The objects usually have similar characteristics. It is critical for a researcher to

find out as much as possible about the targeted population. This study will target investors in 58 listed companies at the Nairobi Stock Exchange with 7,148,250 investors.

### **3.4 Sample Size**

From the population convenience sampling which is non-probability will be used. As the name suggests convenience sampling refers to the collection of information from members of the population which are conveniently available to provide it. This study will be based on 10 top investors of each firm listed in the NSE who happen to hold over 80 percent of shares at NSE. For the purpose of this study, the investors are broadly classified as institutional investors.

### **3.5 Data Collection Instruments**

This study will primarily employ questionnaires in the collection of information. Questionnaires are instruments which have a list of questions in a prescribed sequence that are administered to the respondents Mutai (2000), who will be investors in listed companies at the Nairobi Stock Exchange. Questionnaires can be applied in the collection of huge volumes of data from large samples. They have the advantage of confidentiality, minimal interview bias and saving of time.

Pilot testing using subjects not in the sample will be carried out prior to the questionnaires being used. Participants in the pilot study will be asked to comment on any perceived ambiguities, omissions or errors concerning the draft questionnaire. Suggestions on ambiguous statements will be noted and rephrased to ensure clarity before the questionnaires is used for the intended study. To ensure that the responses tally with the reality, the researcher will apply observation to verify the responses.

### 3.6 Data Analysis and Reporting

The variable in this study to be captured by the questionnaire are classified as under:

Sources of information; Corporate disclosure quality, level of disclosure in the financial reports, importance of items in financial reports, and items in financial reports influencing decision making

In the questionnaire respondents asked to evaluate the above variables using Likert scale. The data generated from structured questions as well as analysis of financial statements will be coded, numbered and classified under different variables for easy identification and then summarized in answer summary sheet.

For data captured using likert scale univariate analysis will be used in extracting information. The main objective of univariate analysis is to summarize the data in a form that enable the researcher gain a feeling of the distribution of data as to draw meaningful conclusions. Given that most questions under the likert scale require ranking e.g. the importance of the information contained in annual reports. The relevant statistics will: Mean, mode, standard deviation, minimum, maximum, number of nonmissing cases, and quartiles. For tests this study will employ any of the following tests: Friedman, Kendall's W, and Cochran's Q.

The Friedman test is the nonparametric equivalent of a one-sample repeated measures design or a two-way analysis of variance with one observation per cell. Friedman tests the null hypothesis that  $k$  related variables come from the same population. For each case, the  $k$  variables are ranked from 1 to  $k$ . The test statistic is based on these ranks. Kendall's W is a normalization of the Friedman statistic. Kendall's W is interpretable as the coefficient of concordance, which is a measure of agreement among raters. Each case is a judge or rater and each variable is an item or person being judged. For each variable, the sum of ranks is

computed. Kendall's  $W$  ranges between 0 (no agreement) and 1 (complete agreement). Cochran's  $Q$  is identical to the Friedman test but is applicable when all responses are binary. It is an extension of the McNemar test to the  $k$ -sample situation. Cochran's  $Q$  tests the hypothesis that several related dichotomous variables have the same mean. The variables are measured on the same individual or on matched individuals.

Responses from non likert scale questions on opinion testing will be recorded in separate sheet and will be organized in themes. Correlation and multiple regression techniques will be used to analyze the primary data of quantitative nature.

### **3.7 Ethical Considerations**

The researcher will maintain integrity in the process by upholding objectivity through out the research. As such, the researcher will declare any interests before hand to avoid any conflict of interest. All information that will be collected shall be treated with utmost confidentiality with the privacy of respondents being maintained at all times.

## **CHAPTER 4: DATA ANALYSIS AND PRESENTATION OF FINDINGS**

### **4.1 Introduction**

The study is an attempt to address the adequacy of information contained in financial statements in making investment decisions. The measures used in the analysis are frequency to capture the number of occurrences of a repeating response, mean to rank the variables, mode to determine the response value score that occurs most often and standard deviation as indicating the level of agreement amongst respondents on an information item.

### **4.2 Respondents Demographics**

The sample contained institutional investors at NSE. A total of 95 questionnaires were sent out and 45 of the respondents answered back, a response rate of about 47%. Out of the forty five (45) respondents, twenty two stated their ages, that varies from 21 years to 56 years, the average age being 38 years. In terms of gender, 25 of respondents stated their gender, twenty (80 per cent) of them are male while 5 (20 per cent) were female.

In terms of education, the majority of respondents, twenty nine (29) or sixty seven percent (67%) had a master degree. The rest are holding first degree. The investment category was institutional investors.

Their investment periods ranged from 3 years to 25 years with an average of 13.42 years. This confirm that investors, sampled, as most likely to be experienced and informed about investing in securities (shares). The average size of the portfolio held by these investors is Shs. 15 billion, while the smallest portfolio is Shs. 500,000. The largest being Shs. 80 billion, with

most of portfolio falling within the 3rd quartile The size of portfolio confirms that most of respondents are big time investors.

### 4.3 Level of Disclosure of Items in Financial Reports

In this sectors respondents are required to rate their satisfaction with the level at which selected items are disclosed in financial statements. The respondents were then invited to express the degree of confidence they attach to each of these items using a Likert-type scale, where (1) referred very poor, and (5), to very good. The results are in table 1 and table 2.

**Table 1: Frequency and Mode - Level Of Disclosure**

Variable	CODE	V.Poor	Poor	Fair	Good	V.Good	TOTAL	Mode
		1	2	3	4	5		
		%	%	%	%	%	%	
Future dividend Prediction	BFDP	8.89	51.11	28.89	8.89	2.22	100	3
Evaluating performance over the time	BEPT	0	20	66.67	11.1	2.22	100	3
Comparison between companies	BCBC	9.09	27.27	45.45	15.9	2.27	100	3
Information Related to Risk	BIRR	2.22	42.22	44.44	8.89	2.22	100	3
Execution of Corporate Strategy	BECS	2.22	20	35.56	40	2.22	100	4
Directors	BDCTS	4.44	22.22	33.33	31.1	8.89	100	3
Environmental & Social	BE&S	0	25	45.45	29.6	0	100	3
Corporate governance	BCG	0	20	44.44	33.3	2.22	100	3
Strategies of Profit	BSOP	0	15.56	46.67	33.3	4.44	100	3
Sales revenue amount	BSRA	0	4.44	15.56	57.8	22.22	100	4
Dividend per share for the period	BDPS	4.44	8.89	24.44	42.2	20	100	3
Sales growth expected	BSGE	2.22	13.33	46.67	26.7	11.11	100	3
Gross value of current assets	BGVCA	0	4.44	31.11	35.6	28.89	100	4
Authorized and issued shares	BAIS	2.22	2.22	26.67	22.2	46.67	100	5
Overall financing costs	BOFC	0	13.33	42.22	37.8	6.67	100	3
Net assets book value	BNABV	0	2.22	35.56	33.3	28.89	100	3
Money resources and uses	BMRU	0	13.33	46.67	35.6	4.44	100	3
Forecast of following year's profits	BFYP	6.67	22.22	48.89	15.6	6.67	100	3
Number and type of shareholders	BNTS	4.44	8.89	31.11	40	15.56	100	3
Information on past balance sheets	BIPS	0	6.67	33.33	35.6	24.44	100	4
Net income	BNI	0	4.44	17.78	40	37.78	100	4
Share price growth	BSPG	7.14	11.9	28.57	28.6	23.81	100	2&3

Their level of satisfaction (rating) varies from very poor (maximum rating) to very poor (minimum) rating. It is clear that the respondents find the level of disclosed information that relates to: net income; sales revenue; authorized and issued shares; gross value of current assets; net assets book value; information on past balance sheets; dividend per share for the period; number and type of shareholders; share price growth as good. Note that these items are historical in nature. The mode rating score is three (fair) for the majority of items under this section, suggesting that there is room for improvement in level of disclosure. Again in table 2, note that nearly all items with a mean score of 3.50 and better (ranked as good) are historical in nature, e.g. net income, sales revenue amount net asset book value etc.

**Table 2 Summary Of Responses on Level Of Disclosure**

Variable	CODE	N	Mean		Rating	StDev	Min	Max
			Mean	Ranking				
Net income	BNI	45	4.11	1	Good	0.86	2	5
Authorized and issued shares	BAIS	45	4.09	2	Good	1.02	1	5
Sales revenue amount	BSRA	45	3.98	3	Good	0.75	2	5
Gross value of current assets	BGVA	45	3.89	4	Good	0.89	2	5
Net assets book value	BNABV	45	3.89	5	Good	0.86	2	5
Information on past balance sheets	BIPS	45	3.78	6	Good	0.90	2	5
Dividend per share for the period	BDPS	45	3.64	7	Good	1.05	1	5
Number and type of shareholders	BNTS	45	3.53	8	Good	1.01	1	5
Share price growth	BSPG	42	3.50	9	Good	1.19	1	5
Overall financing costs	BOFC	45	3.38	10	Fair	0.81	2	5
Sales growth expected	BSGE	45	3.31	11	Fair	0.93	1	5
Money resources and uses	BMRU	45	3.31	12	Fair	0.76	2	5
Strategies of Profit	BSOP	45	3.27	13	Fair	0.78	2	5
Execution of Corporate Strategy	BECS	45	3.20	14	Fair	0.87	1	5
Directors	BDCTS	45	3.18	15	Fair	1.03	1	5
Corporate governance	BCG	45	3.18	16	Fair	0.78	2	5
Environmental & Social	BE&S	44	3.05	17	Fair	0.75	2	4
Evaluating performance over the time	BEPT	45	2.96	18	Fair	0.64	2	5
Forecast of following year's profits	BFYP	45	2.93	19	Fair	0.96	1	5
Comparison between companies	BCBC	44	2.75	20	Fair	0.92	1	5
Information Related to Risk	BIRR	45	2.67	21	Fair	0.77	1	5
Future dividend Prediction	BFDP	45	2.44	22	Poor	0.87	1	5

Min = Minimum; Max = Maximum; StDEv = Standard Deviation.

There is agreement that information contained in annual reports are not useful in predicting dividends, table 1 show that 60 percent (8.89 + 51.11) of respondent consider the level of disclosure of this item as poor and below .That the level of information disclosure is in adequate when it comes to planning and in making decisions is confirmed by low ratings for sales growth, identifying strategies of profit, and corporate strategy. Modern organizations are required to be environmental friendly, practice good corporate governance and to disclose information to that effect in annual reports. However the level of disclosure of information on these items is perceived not adequate.

One would expect investors in shares to seek information that help them manage their investments risk exposure. Mainstream finance literature tells us that investors look at risk and return. However when asked their satisfaction with level of disclosure of information related to risk, most investors (almost 90%) ranked it as fair and below (see table 1).

#### **4.4 Investors Confidence of Information Disclosed In Financial Statement**

In this section institutional investors were asked to indicate the degree of confidence of selected information. Institutional investors require information that helps in evaluating firm's performance, monitoring their investment, predicting earning per share and assessing the liquidity status of firms. In addition institutional investors considered information related to risk, and investment opportunity, as the most important. The respondents were then invited to express the degree of confidence they attach to each of these items using a Likert-type scale, where (1) referred very low, and (5), to very high. The results summarized in table 3 and 4 below. Lack of confidence would require a response from both prepares and regulators of the



annual reports. Confident means having strong belief, firm trust, or sure expectation, feeling certain or fully assured that the information provided is a useful input in the investor's decision model.

The results in table 3 and table 4 show that most investors level of confidence range between high and fair. The most frequent ranking as measure by the mode is fair (3) see table 3.

**Table 3: Frequency of Confidence Ratings**

Variable	CODE	V.Low 1 %	Low 2 %	Fair 3 %	High 4 %	V.High 5 %	TOTAL %	Mode
Future dividend Prediction	CFDP	11.11	37.78	35.56	13.33	2.22	100	3
Evaluating performance over the time	CEPT	0	24.44	35.56	35.56	4.44	100	3&4
Comparison between companies	CCBC	2.22	33.33	33.33	26.67	4.44	100	2&3
Information Related to Risk	CIR	2.22	37.78	40	17.78	2.22	100	3
Execution of Corporate Strategy	CECS	2.22	20	40	35.56	2.22	100	3
Directors	CD	2.22	15.56	46.67	22.22	13.33	100	3
Environmental & Social	CES	0	24.44	37.78	37.78	0	100	3&4
Corporate governance	CCG	0	17.78	57.78	20	4.44	100	3
Strategies of Profit	CSP	4.44	11.11	46.67	33.33	4.44	100	3
Sales revenue amount	CSRA	0	6.67	28.89	44.44	20	100	4
Dividend per share for the period	CDSP	2.22	15.56	24.44	28.89	28.89	100	4&5
Sales growth expected	CSGE	2.27	11.36	36.36	27.27	22.73	100	3
Gross value of current assets	CGVC	0	15.56	33.33	24.44	26.67	100	3
Authorized and issued shares	CAI	0	6.67	33.33	22.22	37.78	100	5
Overall financing costs	COFC	0	13.33	40	40	6.67	100	3&4
Net assets book value	CNABC	0	13.33	28.89	26.67	31.11	100	3
Money resources and uses	CMRU	0	22.22	40	22.22	15.56	100	3
Forecast of following year's profits	CFYP	2.22	24.44	37.78	17.78	17.78	100	3
Number and type of shareholders	CNTS	0	15.56	33.33	26.67	24.44	100	3
Information on past balance sheets	CIPBS	0	11.11	26.67	37.78	24.44	100	4
Net income	CNI	0	4.44	26.67	35.56	33.33	100	4
Share price growth	CSPG	2.22	20	22.22	31.11	24.44	100	4

Most of items that are highly rated are historical and legal data that include net income, authorized and issued shares, number of shares, net assets book value etc. However the level in confidence on information relating to share price growth expected, both rated as high is

surprising given the subjective nature of these two variables. Though information about environmental and social factors and corporate governance is disclosed, the level of confidence in information content of these items is rated as fair, suggesting room for improvement.

**Table 4: Summary of Confidence Ratings**

Variable	CODE	N	Mean	Mean		StDev	Min	Max
				Ranking	Rating			
Net income	CNI	45	3.98	1	High	0.89	2	5
Authorized and issued shares	CAI	45	3.91	2	High	1.00	2	5
Sales revenue amount	CSRA	45	3.78	3	High	0.85	2	5
Net assets book value	CNABC	45	3.76	4	High	1.05	2	5
Information on past balance sheets	CIPBS	45	3.76	5	High	0.96	2	5
Dividend per share for the period	CDSP	45	3.67	6	High	1.13	1	5
Gross value of current assets	CGVC	45	3.62	7	High	1.05	2	5
Number and type of shareholders	CNTS	45	3.60	8	High	1.03	2	5
Sales growth expected	CSGE	44	3.57	9	High	1.04	1	5
Share price growth	CSPG	45	3.56	10	High	1.14	1	5
Overall financing costs	COFC	45	3.40	11	Fair	0.81	2	5
Money resources and uses	CMRU	45	3.31	12	Fair	1.00	2	5
Directors	CD	45	3.29	13	Fair	0.97	1	5
Forecast of following year's profits	CFYP	45	3.24	14	Fair	1.09	1	5
Strategies of Profit	CSP	45	3.22	15	Fair	0.88	1	5
Evaluating performance over the time	CEPT	45	3.20	16	Fair	0.87	2	5
Execution of Corporate Strategy	CECS	45	3.16	17	Fair	0.85	1	5
Environmental & Social	CES	45	3.13	18	Fair	0.79	2	4
Corporate governance	CCG	45	3.11	19	Fair	0.75	2	5
Comparison between companies	CCBC	45	2.98	20	Fair	0.94	1	5
Information Related to Risk	CIR	45	2.80	21	Fair	0.84	1	5
Future dividend Prediction	CFDP	45	2.58	22	Fair	0.94	1	5

Min = Minimum; Max = Maximum; StDev = Standard Deviation.

The standard deviation for most items in tables 2 and 4 is one (1) or below. These suggest agreement among respondents. The rank correlation coefficient between level of disclosure and confidence in finance statement is + 0.99 suggesting that respondents positively relate level of disclosure to level of confidence.

The result highlights information areas which institutional investors would require improvements on. Of concern are items that are lowly rated but capture the quality of management such as corporate governance and information that can be used in estimating risk and future share prices.

#### **4.5 Summary and Interpretation of Findings**

This chapter has analyzed perception of users regarding the level of disclosure and investor confidence levels of information disclosed in the financial reports of companies listed on the Nairobi Stock Exchange. The average size of the portfolio held by institutional investors stood at Ksh15 billion which shows that most of the institutional investors are major players in the market and their trading activities can have an impact on the direction that the market takes. The average investment period at 13.42 years indicates the long term outlook of most of the institutional investors in the stock exchange.

The analysis has revealed that institutional investors were moderately satisfied with the level of disclosure with items in the financial statements that are historical in nature like, net income; sales revenue; authorized and issued shares; gross value of current assets; net assets book value; information on past balance sheets; dividend per share for the period; number and type of shareholders; share price growth, more than those that are not historical in nature such as: future dividend prediction, information related to risk, and corporate governance practices. This could be affecting investment decisions and participation of institutional investors in the NSE. Institutional investors also do not find annual reports useful in predicting dividends, and that the level of information disclosed in the reports was inadequate when it came to planning and decision making. Information helps investors to determine risk and the risk related information

disclosure is considered fair which does not augur well for a market like the NSE which is keen for the attraction of foreign investors.

Institutional investors were moderately confident with the information disclosed in financial statements of companies listed in the NSE, and were most confident with items of historical and legal data compared to information on environmental and social factors and corporate governance. It also showed that institutional investors found there to be a positive relationship between levels of disclosure of information in annual reports and level of confidence with the information disclosed in the financial reports. The result highlights information areas which institutional investors would require improvements on. Of concern are items that are lowly rated but capture the quality of management such as corporate governance and information that can be used in estimating risk and future share prices.

The institutional investors find that there is still room for improvement for most of the items disclosed in the financial reports of listed companies and more so improvement is necessary in the items that investors rated their disclosure level to be fair such as: overall financing cost; sales growth expected; money resource and use; strategies of profit and execution of corporate strategy. It can also be noted that for the various items that institutional investors find to have room for improvement, their confidence levels was also found to be fair thus showing that if the improvements could be made in the annual reports of the listed companies then this would lead to increased investor confidence with the information contained in the financial reports and therefore enhance decision making by institutional investors.

## CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

### 5.1 Summary

This study aims to assess whether investors at the NSE market perceive the financial information disclosure as relevant for their investment decision process. It is based on the thesis that information is an important communication tool between all efficient market partners (Freedman and Stagliano, 2002). Therefore this study set out to establish the institutional investors' perception on the level of disclosure and confidence on selected items contained in financial statements.

The study found out investors confidence on the item contained varied from very low to very high, with most investors having high confidence data that is largely historical. Investors are less confident using the information for forecasting future dividends and in risk management. The reliability of disclosure relating to corporate governance and environmental and social responsibility is doubtful. Investors even find it difficult using financial information to compare performance of firms. In some instances investors as users of information evaluated the company's

In relation to level of disclosure investors overall rating is fair most of the items. The items that they consider adequately disclosed relate to items that are not contentious such as number of shares.

## 5.2 Conclusion

The study was in line with Elliot (2006) observation that the goal of general purpose financial statements is to disseminate information regarding the financial state, financial performance, and cash movements that is of use to several stakeholders. The study has reported the results of an investor's perception of information used in financial statements that is useful in forecasting share prices. As the issue of level of disclosure of and confidence of different parts of the corporate annual report are concerned, the respondents made it clear that they had no full confidence in all sections contained in the financial report. Therefore, from the institutional user perception, one cannot be assertive that financial statements in their present form are regarded sufficient in formulating investment decisions.

However to some extent these findings are not surprising. As was mentioned in literature review, though most of studies provide evidence that annual report is an important source of information, they report low association between accounting numbers and stock prices or returns. Studies even report a decreasing trend in the value-relevance of financial statement information (Francis and Schipper, 1999). This could explain low rating by respondents in this study.

From the study of Al-Mubarak (1997) who confirms that the annual corporate report is the primary source of corporate information, and Abdelsalam (1990) who find that investors read the annual reports, with a lot of emphasis on income statement, together with the results of this study, there is need to improve on the quantity and quality of items disclosed by NSE listed companies. It is only after improvements that such information can create fair stock price value.

### **5.3 Policy Implications and Recommendations**

The preparers and regulators can make the information in financial statement more relevant and useful to investors by including information that is useful in evaluating corporate governance, information related to risk, forecasting of earnings and environmental and social responsibility. Preparers of annual report should comply with the minimum international disclosure requirements. The information published by companies listed at Nairobi Stock Exchange should be sufficient to assess risk, estimate corporate performance and conduct comparisons between firms in the same sector. This in turn would help to increase the levels of investor confidence on the above aspects of the financial reports.

It is possible that users of financial statements are not competent or lack capacity to derive full benefits of information contained in financial statements. In which case there is need to improve on investment culture and financial information process for investors through education and training, whereby it would be required that companies are required to hold investor seminars frequently to educate the investors on the various aspects of the annual financial reports and thus this would ensure that investors are able to make more informed investment decisions. Companies should be encouraged to practice voluntary disclosure on information items that influence investment decisions and be required to give a simplified interpretation of the information contained in the annual reports, and this should be attached with the financial reports released at any one time.

#### **5.4 Limitation of the study**

The major limitation was getting the investors to respond to the questionnaire. A number of them were reluctant disclosing any information that expose their decision making process. This explains the low response rate. The limitation of using a questioner to capture information must be noted. Observation experimental and or content analysis could be more relevant.

The other limitation relates to time, and it was not possible focusing on all investors. Other studies are made richer by focusing on all investor types, time could not allow this in this study. The final limitation has to do with perception. It is not clear the extent to which perception plays a critical role in the daily decision making process for all investors in this market. It is also not clear whether investor's behavior is based on their perception of what reality is and not on reality itself.

#### **5.5 Areas for further Research**

A further research may extend analysis to include all categories of investor to establish significant differences among the multi users' perception of information as was in Abu-Nassar and Rutherford (1996). It is important researching on whether the information disclosed is timely, relevant and reliable using.

Research on how investors make investment decision and how they actually incorporate financial information in their decision models is recommended and how financial information competes with other sources of information. Such a study will have to be empirical. For example a study on how investors assess risk could provide guidance about which disclosures can aid investors in assessing risk.



Another potential research area would be to evaluate compliance levels in relation corporate governance. This will enable prepares of financial reports to address the reporting shortcoming in this important item.

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**APPENDIX**  
**QUESTIONNAIRE**

Please fill in the following questionnaire

**Part A: Demographics**

Name (Optional).....

Age.....

Gender.....

Level of education (*Tick one option*)

Secondary School Certificate [  ] Bachelors Degree [  ] Masters Degree [  ]

**Investor Category** (*Tick one option*)

Institutional investor [  ]

How many years have you been active at the Nairobi Stock Exchange?

.....

What is the value of your portfolio? (*Amount in Kenya Shillings*)

.....  
.....

**PART B: Level of Disclosure Source of financial reports**

How would you rate the level of disclosure for the indicated items in the financial reports for listed companies (*tick where applicable*).

5= Very good      4= Good      3= Fair      2= Poor      1= Very poor

	1	2	3	4	5
Future dividend Prediction	[ ]	[ ]	[ ]	[ ]	[ ]
Evaluating performance over the time	[ ]	[ ]	[ ]	[ ]	[ ]
Comparison between companies	[ ]	[ ]	[ ]	[ ]	[ ]
Information Related to Risk	[ ]	[ ]	[ ]	[ ]	[ ]
Execution of Corporate Strategy	[ ]	[ ]	[ ]	[ ]	[ ]
Directors	[ ]	[ ]	[ ]	[ ]	[ ]
Environmental & Social	[ ]	[ ]	[ ]	[ ]	[ ]
Corporate governance	[ ]	[ ]	[ ]	[ ]	[ ]
Strategies of Profit	[ ]	[ ]	[ ]	[ ]	[ ]
Sales revenue amount	[ ]	[ ]	[ ]	[ ]	[ ]
Dividend per share for the period	[ ]	[ ]	[ ]	[ ]	[ ]
Sales growth expected	[ ]	[ ]	[ ]	[ ]	[ ]
Gross value of current assets	[ ]	[ ]	[ ]	[ ]	[ ]
Authorized and issued shares	[ ]	[ ]	[ ]	[ ]	[ ]
Overall financing costs	[ ]	[ ]	[ ]	[ ]	[ ]
Net assets book value	[ ]	[ ]	[ ]	[ ]	[ ]
Money resources and uses	[ ]	[ ]	[ ]	[ ]	[ ]
Forecast of following year's profits	[ ]	[ ]	[ ]	[ ]	[ ]
Number and type of shareholders	[ ]	[ ]	[ ]	[ ]	[ ]
Information on past balance sheets	[ ]	[ ]	[ ]	[ ]	[ ]
Net income	[ ]	[ ]	[ ]	[ ]	[ ]
Share price growth	[ ]	[ ]	[ ]	[ ]	[ ]



**Part C: Investor's and other Financial Statement Users Reaction or confidence on the information provided in the financial reports.**

How would you rate your confidence in the following items of the financial reports of listed companies?

*(Tick where applicable)*

5= Very High    4= High    3= Fair    2= Low    1= Very Low

	1	2	3	4	5
Future dividend Prediction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Evaluating performance over the time	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Comparison between companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Information Related to Risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Execution of Corporate Strategy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Directors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Environmental & Social	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate governance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Strategies of Profit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sales revenue amount	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Dividend per share for the period	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sales growth expected	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Gross value of current assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Authorized and issued shares	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Overall financing costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Net assets book value	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Money resources and uses	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Forecast of following year's profits	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Number and type of shareholders	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Information on past balance sheets	[ ]	[ ]	[ ]	[ ]	[ ]
Net income	[ ]	[ ]	[ ]	[ ]	[ ]
Share price growth	[ ]	[ ]	[ ]	[ ]	[ ]