An Analysis Of The Usefulness Of Annual Financial Statements To Credit Risk Analysts In Kenyan Commercial Banks

By

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A management research project submitted in partial fulfilment of the requirements of the degree of Masters in Business Administration of the University of Nairobi.

August 2003

DECLARATION

This research is my original work and has not been presented for a degree in any other University.

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

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ACKNOWLEDGEMENTS

May I first and foremost thank my supervisor Mr. Luther Otieno Odhiambo for his confidence-inspiring and enthusiastic support.

May I also thank my fellow MBA students for their support throughout the course. Special thanks to Matu Mugo, Linda Kamau, J. Oltetia, John Musau, Dan Obiero, Joyce Mutanu, Chris Otieno and T.K. Kimutai.

Dulacha B. Galgalo, a PHD student at the University of Western Australia, Perth, also deserves a special mention for his encouragement and untiring support.

Last but not least, to all who supported me in one way or the other, I am most grateful.

DEDICATION

This project is dedicated to my parents who leant the hard way that lack of formal education in today's world is a handicap and ensured that I avoided the pitfall.

To my family who bore the brunt of sacrifices that we had to undergo to make this additional step in my life possible.

ABSTRACT

The management of risk is key to the success of any organization. In the financial sector the most significant risk is credit risk. The import of credit risk can be seen from the fact that the primary reason a bank fails or falls into big trouble are bad loans or too many other bad debts (Nickson, 2002). The Kenyan banking sector, in particular, has been ailed over the years by the relatively high level of non-performing loans i.e. 30 percent of its total loans have been non-performing as at 30-12-2001 (CBK).

Information is a crucial ingredient in the management of risk. According to Berry et al., 1993 and Danes et al., 1989 financial information is the most valuable information in the bank lending decision. Financial reports and statements about a company are a key source of information in a assessing its financial condition (Coyle, 2000). Yet according to Jarvis et al, 1996 very little is known as to how users of corporate financial reports use the information contained in these reports.

The study consequently had three objectives; to establish whether credit risk analysts in Kenyan commercial banks use financial statements in credit risk assessment, to identify the sections of annual reports which credit risk analysts find most useful and to find out from credit risk analysts in Kenyan commercial banks improvements that can be made to financial statements.

All the commercial banks operating in Kenya were sampled and asked to provide information through the use of questionnaire. The respondents for the study were the credit risk analysts of the banks.

The study revealed that credit risk analysts use information derived from financial statements in their lending decisions. The study showed that credit risk analysts do not rely on only one source of information. Credit risk analysts also indicated that they would like some improvements made to annual reports.

These results are expected to be useful both for organizations seeking loan finance and for accounting standards setters. They are also useful as a reference point for comparative studies that might be undertaken in other African countries.

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CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1 INTRODUCTION

Financial statements (and other information) are widely used in loan decisions (Foster, 1986). These decisions not only involve whether to grant the loan, but also what interest rate to charge, the loan amount and any restrictive covenants in the loan agreement to be placed on the borrower. This study reviewed the use made of annual financial statements by loans officers in Kenya.

In assessing credit, risk loan officers utilize financial statements and consider many other factors when deciding whether to approve a loan. For secured loan, an important determinant in the loan decision process is the value of collateral. For an unsecured loan, the financial status of the business is especially pertinent to the loan approval decision (CPA Journal 1990).

The purpose of credit analysis is to reach a judgment about a customer's ability to pay. The analyst must therefore make an assessment of the company's financial position, and in particular its solvency and liquidity. Financial reports and statements about the company are a key source of information in this process (Coyle, 2000).

1.2 STRUCTURE OF THE BANKING SYSTEM IN KENYA

There were 43 commercial banks, 2 non-bank financial institutions (NBFIs), 2 mortgage finance companies, 4 building societies and 48 forex bureaus in the banking system in Kenya as at the end of February 2003 (See table 1.1 below).

Table 1.1 Banking Institutions in Kenya

Type of Institution	No. as at February 2003
Commercial Banks	43
Building Societies	4
Mortgage Finance Cos	2
NBFIs	2
Forex Bureaus	48
Total	99

Source: Central Bank of Kenya

1.3 NON-PERFORMING LOANS IN KENYA

Net loans at the level of shs215 billion as at December 31, 2001 accounted for 51% of total net assets of Kenya's banking sector. At the same date the proportion of non-performing loans to total loans in Kenya was a high of 30%. As at 31st December 2001 non-performing loans amounted to shs74 billion (Bank Supervision Annual Report, 2001).

The trend of non-performing loans in Kenya over the last five years is shown in table 1.2 below:

Table 1.2 Non-Performing Loans 1995-2000

Year	NPLs	Total Loans	NPLs/Total Loans
	Shs Billions		%
1995	31.8	180.2	17.6%
1996	37.9	213.7	17.7%
1997	69.0	248.2	27.8%
1998	83.5	268.6	31.1%
1999	97.3	284.2	34.2%
2000	90.2	272.9	33.1%
2001	73.6	245.0	30.0%

Source: Central Bank of Kenya

The slight decline in the last two years (2000-2001) is explained by Central Bank of Kenya in its 2001 Bank Supervision Annual Report to be the result of the exit of the collapsed Trust Bank and partially to recoveries, write-off and write-down of some debts in a number of institutions.

Comparing, the ratio of non-performing loans to total loans (NPLs/TL) in Kenya of 33% to similar African economies at the end of 2000, Central Banks of these countries reported that, this ratio (NPLs/TL) is much lower in Zimbabwe (24%), Nigeria (11%) and South Africa (3%) (Bank Supervision Annual Reports, 2000).

1.4 PROBLEM STATEMENT

Lenders require information to make their loan analysis on which they base their lending decisions. Poor credit risk assessment leads to bad credit decisions. Financial information is the most valuable information in the bank lending decision (Berry et al, 1993: Danes et al., 1989). Very little is known as to how users of corporate financial reports use the information contained in these reports. (Jarvis et al, 1996).

In Kenya credit risk evaluation standards are questionable as attested to by the extent of non-performing loans in the country. Further most of the financial institutions (54 of the 60) that collapsed since 1988 failed due to non-performing loans (Murugu, 1998).

Few researches have been done in the area of credit risk assessment in Kenya. Recent studies were done by, Mucheke (2001) who looked at the causes of non-performing loans and Kabiru (2002) who studied credit risk assessment practices in Kenya. None of these studies specifically focused on the use of annual financial statements by loan officers in credit risk assessment. The present study, therefore, extend this field (credit risk assessment) of research to understand the use of annual financial reports by credit risk analysts in Kenya.

The aims of this study are to: (i) establish whether credit risk analysts in Kenyan Commercial Banks use financial statements in their quest for information on credit risk assessment, (ii) identify the sections of annual reports, which they find most useful and, (iii) find out from them improvements that can be made to financial statements.

1.5 OBJECTIVES OF THE STUDY

This study focuses on the following research issues:

- To establish whether credit risk analysts in Kenyan Commercial Banks use financial statements in credit risk assessment;
- To identify the sections of Kenyan annual reports which credit risk analysts find most useful; and
- To find out from credit risk analysts in Kenyan Commercial Banks improvements that can be made to financial statements.

1.6 IMPORTANCE OF THE STUDY

The findings of this study would be useful to:

- Borrowers, who need to be aware of lenders information requirements,
- Accounting regulators, who are concerned with improving the information context of external reports.
- Bank regulators in making appropriate policy guidance in lending.
- Banks in making necessary policy changes with regard to their use of annual financial reports.
- Those involved in training accountants.

CHAPTER TWO 2: LITERATURE REVIEW

2.1 INTRODUCTION

The quality of credit risk analysis depends on the amount of reliable financial information available. Banks are often able to insist on audited financial statements as a precondition of lending and should be able to carry out a better analysis of credit risks as a result (Coyle, 2000).

2.2 FINANCIAL STATEMENTS AVAILABLE

Some financial statements report historical results while others report future projections. They include:

- The company's annual report and accounts
- Interim statements for public corporations. Quarterly for banks and half-yearly for other quoted companies.
- The company's internal management accounting statements (for example, detailed statements of monthly or quarterly profits)
- Budgets or similar financial forecasts, such as a cash budget or profits budget
- A financial forecast within a business plan.

The main advantages of annual report and accounts are that they are audited and are readily obtainable, however, they are at least several months out-of-date.

The company's Act Cap 486 section 125 requires that every company having share capital must once in a year make a return to the Registrar of Companies, containing the particulars set out in the Fifth Schedule to the Act. According to the Fifth Schedule there must be annexed to this return a copy of balance sheet, auditors and directors report.

The most useful financial statements for analysis are the management accounts and budgets or forecasts, because these should be reasonably up to date. They give a better insight into the state of the company, what it has recently achieved and what it expects to achieve.

Whereas annual accounts and interim statements are usually readily obtainable, it is not easy to get hold of management accounts or forecast statements for analysis, although banks are in the best position to do this. A bank can insist that as a condition of lending, the company must provide financial information before it makes a lending decision so that some credit analysis can be carried out. The bank could also call for financial information at regular intervals, either during the course of a loan agreement (to ensure that the borrower is adhering to specified loan covenants) or as a condition for continuing to provide an overdraft facility.

2.3 CONTENTS OF ANNUAL FINANCIAL STATEMENT

According to Coyle(2000), annual financial statements of a group of companies have several elements:

- CEO's or chairman's report
- Directors report
- Auditors report
- Consolidated balance sheet for the group
- Parent company balance sheet
- Consolidated statement of income
- Consolidated cash flow statement
- Notes to the account, providing supplementary details.

The accounts of public companies almost invariably consist of consolidated financial statements for the entire group of companies, of which the reporting company is the parent or holding company. (There is also a balance sheet for the parent company itself, but not an income statement.)

For credit analysis, it is important to recognize that a group of companies is not a legal entity. When credit is granted, the debt obligation belongs to the individual company within the group that obtains the credit. In the event of default, the lender or creditor has redress against that company, not against the group as a whole nor the parent company.

The only exceptions to this is when the parent company itself is granted the credit, (in which case the lender or creditor will take action against the parent in the event of default) or when the parent company and/or other companies within the group have provided guarantees of payment in the event of default by the borrowing subsidiary.

The point to note is that consolidated group accounts are of limited use for credit analysis, unless

- The applicant for credit is the dominant trading company in the group, or
- The parent company guarantees the debts of its subsidiary, or
- The company that is asking for credit is the parent company itself (although even here, the consolidated accounts might be a poor guide for reliable credit analysis).

2.4 LOAN ASSESSMENT

The loan appraisal process is the process of identifying risks inherent in a loan application and pricing it appropriately.

Rouse(1989) suggests that the principles of good lending for banks can be reduced to a simplified framework, summarized in a useful mnemonic, Campari.

C character (the person)

A ability (to run the business)

M margin (bank risk reward)

P purpose (does the bank understand the business?)

A amount (is the loan amount adequate/excessive?)

R repayment (how does the bank get its money back?)

I insurance (what is the security?)

Character

This is a difficult area but a vital one to get right. Facts, not opinions are crucial, for example:

- How reliable is the customer's word as regards the details of the proposition and the promise of repayment?

- Does the customer make exaggerated claims, which are far too optimistic, or is a more modest and reasonable approach adopted.
- Is the customer's track record good? Was there any previous borrowing, and if so, was it repaid without trouble?
- If the customer is new, why are we being approached? Can statements be seen to assess the conduct of the account?

Ability

This aspect relates to the borrower's ability in managing financial affairs and is similar to character as far as personal customers are concerned.

Further points in respect of business customers would include:

- Is there good spread of skill and experience among the management team in, for example, production, marketing and finance.
- Does the management team hold relevant professional qualifications?
- Are they committed to making the company successful?
- Where the finance is earmarked for a specific area of activity, do they have the necessary experience in that area?

Margin

Agreement should be reached at the outset with the borrower in respect of interest margin, commission and other relevant fees. The interest margin will be a reflection of the risk involved in the lending, whilst commission and other fees will be determined by the amount and complexity of the work involved.

It should never be forgotten that banks are in business to make profits and to give shareholders return on their capital.

Purpose

The lender will want to verify that the purpose is acceptable.

Perhaps the facility would not be in the customer's best interests. Customers do tend to overlook problems in their optimism and, if the bank can bring a degree of realism to the proposition at the outset, it may be more beneficial to the customer than agreeing to the requested advance.

Amount

Is the amount the customer is asking for either too much or too little? There are dangers in both and it is important therefore to establish that the amount requested is correct and that all incidental expenses have been considered. The good borrower will have allowed for contingencies.

The amount requested should be in proportion to the customer's own resources and contribution. A reasonable contribution from the borrower shows commitment and a buffer is provided by the customer's stake should problem arise.

Repayment

The real risk in lending is to be found in the assessment of the repayment proposals. It is important that the source of repayment is made clear from the outset and the lender must establish the degree of certainty that the promised funds will be received.

Where the source of repayment is income/cashflow, the lender will need projections to ensure that there are surplus funds to cover repayment after meeting other commitments.

Insurance/Security

Ideally, the canons of lending should be satisfied irrespective of available security, but security is often considered necessary in case the repayment proposals fail to materialize.

It is vital that the provider of security, especially third party security, understands fully the consequences of charging it to the bank. It is equally important that no advance is made until security procedures have been completed, or are at least at a stage where completion can take place without the need to involve the borrower any further.

The realization of security may provide a source of repayment in the last resort. However, the sale of security is rarely as straight forward in practice as it appears in theory and security valuations often do not stand up to the ultimate test of realization.

There will be many cases where the lender feels the risk in the proposition is not tenable. A lender will wish to help a good customer and, if a proposition can be 're-engineered' into a more acceptable form, this should be done.

Security and ability to repay are both mentioned as corporate characteristics, which can be, and have been, measured with the data set collected. There is some evidence that the importance of security to UK bankers has diminished over time (Berry et al, 1987). This can be coupled with substantial evidence that bankers are concerned with the extraction of profit figures. However, the security issue still seems to be significant in relation to applications by small firms.

2.5 SOURCES OF INFORMATION FOR MAKING LOAN DECISIONS

According to Foster (1986) the information sources an analyst can access include:

(i) Loan Applicant.

Information requested from the applicant can include past financial statements, projections of financial statement items (for example, cash flow), descriptions of the assets offered as collateral, and details of business plans and management experience.

(ii) Lending institution files and personnel.

If the applicant is already a client of the bank, information about the prior payment record, the past track record of management, and so on may be readily available. Even if the applicant is a new client, information in the loan institution's files about "comparable firms" (for example, those in the same industry) can be useful in decision-making. This information can be accessed in a heuristic way or via the development of a distress prediction model, a numerical scoring system, or a similar computerized data analysis technique.

(iii) External Credit Surveys.

Bond- and credit-rating services provide information on many potential clients of a lending institution.

(iv) Factor, Labour and Product Markets.

Each of these three markets can be a rich information source about the ability of a firm to retain the support of suppliers, customers and so on. Issues relevant to loan analysis include the reliability of supply sources, the timing of wage contract negotiations, and the time trend of market share. Information about the competitors of the client, as well as about the client itself, can be critical in predicting the likely ability of a firm to make interest and principal repayments.

(v) Capital Markets.

By explicitly incorporating capital market information in the loan decision process analysts can exploit two important features of the capital market: (a) its forward-looking orientation and (b) its utilization of information from a broad spectrum of sources. Even if the applicant is privately held, the loan analyst can still use capital market information relating to other firms in the industry to gain insight into expectations of future developments in that industry. Capital market variables can be especially useful as a monitoring device for an existing loan as they may capture adverse developments before they are reflected in financial statements. Specific capital market variables include security price movements, option price movements, and trading volume statistics. In addition, reports from brokerage firms can provide useful insights about likely future developments, the quality of management, and so on.

(vi) Industry and Economy Reports.

An analyst can access numerous source of information in this area, for example, industry trade group forecasts, forecasts made by economists or econometric models, and reports from government departments and agencies about money supply, gross national production, and taxation.

These information sources differ in several dimensions, for example, qualitative versus quantitative, past versus future oriented, and verifiable versus non-verifiable. The challenge facing a loan analyst is to exploit these diverse information sources in a cost-effective and efficient way.

2.6 COMMERCIAL LENDING PROCESS

Appendix IV presents an overview of three stages in the commercial lending process (Cohen, Gilmore, and Singer, 1966, and Altman, 1980, present similar overviews):

- Loan approval
- Loan monitoring
- Loan termination

There are two related reasons for studying how existing decisions are made in one or more of these processes. One reason is to gain insight into the role that financial statement and other information play in these decisions. A second reason is to examine areas where 'innovations' can lead to improved loan decisions. An understanding of the current loan decision-making process facilities placing shilling magnitude on the expected gains from implementing improvements. These improvements could be manifested in several areas, for example, a reduction of current loan processing costs, an increase in the consistency with which analysts apply the bank's loan loss function, a reduction in loans made to clients that subsequently default, and an increase in loans made to clients that repay interest and principal in a timely manner.

An important but little researched area is the integration of financial statement information with other information in loan decisions. The latter includes strategy information about the firm and its competitors and capital market information. For instance, strategy analysis could help flag potential problem situations such as (a) loan applicant is currently profitable, but, due to several competitors constructing large-scale state-state-of–the art plants, applicant will need to make sizable investments in a new plant to remain profitable and (b) loan applicant is experiencing rapid growth and high profitability, but both these factors could be quickly eroded by a competitor's technological breakthrough.

Capital market information can be especially useful in the loan review process. Given the ability of capital markets to impound new information rapidly, lending institutions can use sudden drops in security price as a prompt for internal review of the loan. Little research has been published in this area, and at present most loan officer training programs do not include detailed segments on either strategy analysis or capital market analysis.

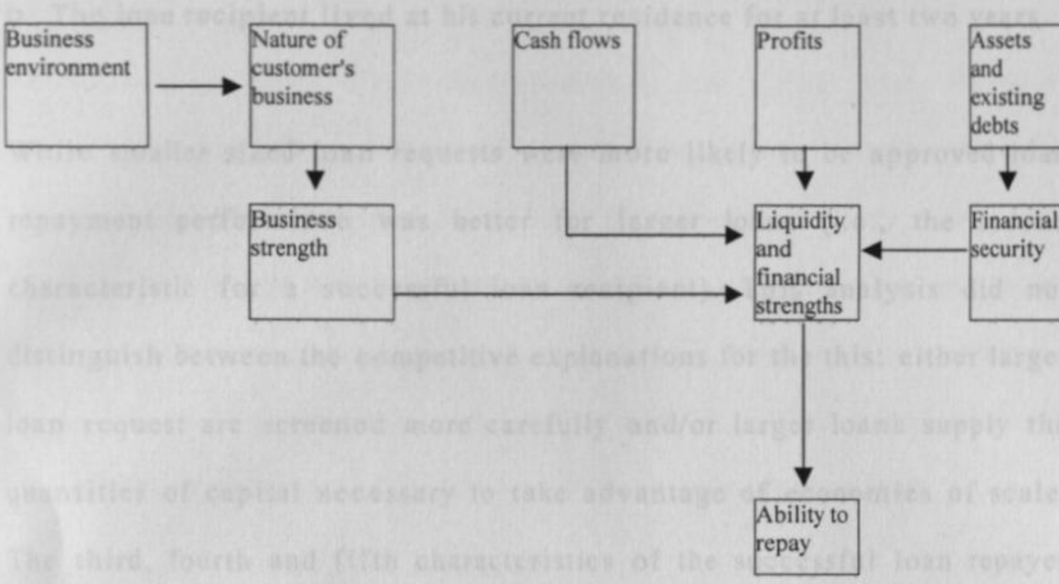
One example of progress in this area is Stein and Ziegler's (1984) analysis of corporate credit risks in Germany. This study integrated assessments of the quality of management with balance sheet variables based on transactions made on the current bank account. It was reported that simultaneously combining these three sets of variables "avoids deficiencies of using only one of the components and improves the early detection of credit risks".

2.7 CREDIT RISK ANALYSIS

The purpose of corporate credit analysis is in a nutshell to judge the liquidity and financial strength of a company. This involves a study of the business, its markets and market position, its management and its financial situation.

Corporate credit analysis may be summarized into the areas diagrammatically shown below:

Corporate Credit Risk Analysis



Corporate Credit Analysis (Brian Coyle 2000, Page 5)

The key issue explored by Eldestein (1975) in his paper, 'Improving the Selection of Credit Risks', was how a bank differentiates between potentially good and bad credit risks. Five characteristics on the loan application were found to be the best statistical predictors of successful loan repayment for loan recipients. These characteristics were:

- The loan recipient received his loan toward the chronological end of the survey period of the program;
- The loan recipient received a relatively large loan;
- The loan recipient had at least seven years of employment experience that was related to the type of business for which the loan had been sought;
- The loan recipient had accumulated a relatively large personal net

worth; and

- The loan recipient lived at his current residence for at least two years.

While smaller sized loan requests were more likely to be approved loan repayment performance was better for larger loans (i.e., the second characteristic for a successful loan recipient). This analysis did not distinguish between the competitive explanations for the this: either larger loan request are screened more carefully and/or larger loans supply the quantities of capital necessary to take advantage of economies of scale. The third, fourth and fifth characteristics of the successful loan repayer are more traditional. They allegedly demonstrate financial solvency and individual stability. Finally it was discovered that the probability of successful loan repayment increased if a retail or wholesale business were located in a relatively low income. This may, in part, be explained by the spatial monopoly of ghetto enterprises.

This analysis, as in prior studies, discovered that relatively few variables were required for the accurate prediction of credit performance. The variables that appear to be important predictors of credit-worthiness in these previous studies can be categorized into measures of fiscal performance, such as financial balance sheet data or financial ratios, and measures of stability/responsibility, such as the length of time employed.

2.8 EMPIRICAL LITERATURE REVIEW

Research has established that personal interviews and financial information are the main information sources in the bank lending decision (Berry et al, 1993: Danes et al., 1989). The smaller the size of the firm the less important the financial information as it is perceived to be unreliable (Danos, 1989) and the more important the personal interviews. Large non-family run firms tend to employ qualified accountants to produce more detailed and more frequent accounting information.

A survey by Stephens (1980) of bank lending officers revealed that half of them would refuse to loan to a company that did not submit financial statements, even though these might not be explicitly requested. Bank lending officers exhibited no preference for inventory or depreciation methods, but believed that consistency in the use of accounting methods is important.

However, banking systems show marked differences between countries (Berry et al., 1993) so it is difficult to generalize between countries. Most research studies have been carried out in the United States and (to a lesser extent) the United Kingdom. There are significant differences in the reported findings between these two countries. For example, reports from credit agencies and "Z" scores (Altman, 1968) are widely used in the United States (Danos et al., 1989) but apparently little used in the United Kingdom (Berry et al., 1993).

However, bearing the above in mind, the US and UK evidence shows that bank lending decisions are based upon the review of:

- Audited financials statements (usually for the past 3 years in order to assess the companies past record) with particular emphasis placed on balance sheets, profit and loss accounts, notes to the accounts, auditor's report and directors'/chairman's report.
- Flow of funds statements were of variable importance (Berry et al., 1991). The data collected is often put into banks in-house analysis sheets, which typically highlight key figures and ratios (i.e. traditional financial analysis).
- Pro forma updated financial statements
- Cash forecasts/budgets
- Management accounts
- Age/markets analysis of debtors and creditors (Berry et al., 1991).

However the weight attached to each of the above varies according to the firm's size, the personal characteristics of the loan officer (e.g. age, qualifications) and the loan duration.

Banks often request changes to a firm's accounting system (e.g. computerization, new appointments, more frequent reporting) and maintain regular contact with firms. Danos et al. (1989) identify three phases in the lending process:

- Phase One: Gather background information about the borrower (e.g. company history and credit rating, location and type of business, number of employees, names of directors, key employees and owners). Credit ratings are used which contain summarized financial reports, auditor names, and so on.
- Phase Two: A location visit to "size up" the business and collect any missing data from Phase One. Discussions with key employees regarding use of the loan and its repayment.
- Phase Three: Detailed financial information is collected (e.g. full accounts, budgets, and forecasts). Assessments of the organization and its ability to repay the loan are made. Assumptions underlying the financial information are assessed. The decision to make/not make the loan is made.

In his study of 'Financial Ratios as Perceived by Loan Officers', Gibson (1983) reviewed how commercial loan officers in the United States viewed specific financial ratios through the use of questionnaires. Their views were determined in terms of what a specific ratio primarily measures, the significance (importance) of a particular ratio, and its frequency of inclusion in loan agreements. Ratios that are viewed as being highly important are likely to be ratios that influence a commercial loan officer on whether to grant a loan. The three ratios rated as the most important were Debt/Equity, Current Ratio, and Cash Flow/Current Maturities of Long-Term Debt. Two of these are debt ratios and one is a liquidity ratio. Ratios that are incorporated into loan agreements are likely to be ratios that would help control a loan or ratios that would prevent excessive funds from being paid out to stockholders prior to the payment of the loan. The three ratios most likely to be included in loan agreements were indicated to be the Debt/Equity, Current Ratio, and Dividend Payout Ratio.

He found the following other ratios to be also significant.

- Fixed charge coverage
- Net profit margin (before and after tax)
- Net interest earned
- Inventory turnover
- Accounts receivable turnover

This is consistent with Backer (1970, p. 57) who surveyed American loan officers and found they tend not to be concerned with subjective accounting methods, so long as there is full disclosure, which allow appropriate adjustments to be made to financial statements. Zimmer (1979) found that loan officers rely greatly upon revenue recognition disclosures. Dietrick and Stamps (1981) found loan officers use such information to adjust financial statements in line with "standard industry practice" or "appropriate to the circumstances".

Pike and Ross (1997) ranked the relative importance of the sources and types of credit information used by Canadian managers to assess the risk of foreign buyers. Information use variances among export credit managers are also investigated in light of differences in financial cost and risk aversion and marketing benefit attraction orientations, export credit insurance use and selected biodata characteristics. The study found that even for export sales, the primary focus of credit managers is on information about the buyer's credit character and financial strength, while political and economic risk information is generally of much less importance.

According to this study, Canadian export credit managers, overwhelmingly used domestic-type credit information sources and items when assessing the credit risk of foreign buyers. Of the domestic credit information types used by the managers, most attention was placed on payment record indicators. Oddly, financial strength indicators were used less frequently than the other standard credit risk indicators-even though earlier studies show that credit managers perceive the buyer's financial strength as the most important factor in assessing creditworthiness. Export specific credit information sources and other items are used only infrequently by Canadian export credit managers-perhaps due to the concentration of their export sales to the USA and other, relatively safe, export markets.

According to (Otieno et al, 1999), as far as the UK is concerned, 'traditional approaches' are seen as characterizing the use of financial data by bank lending officers. There is no evidence of substantial computerization of the process, and little evidence of the use of novel ways of combining financial variables, such as Z scores. This contrasts with reported US experience.

McMonnie (1988) takes the view that user needs should be a key determinant of form and content of financial reports, and that bank-lending officers (BLOs) are a key significant user group.

McMonnies is one of several documents published that have attempted to provide an all-embracing corporate reporting framework from a user perspective. McMonnies represents a set of proposals that are far removed from current practice. These proposals include disclosure: of forecast information, information on the economic environment and the human resources employed by the companies. The items addressed by McMonnies within this disclosure framework specifically considered in this paper are cash flow, assets, profit, future oriented information and non-financial information.

The profitability of the business was found to be of importance to the BLOs but it seems more emphasis is given to cash flows as a measure of business performance. Key profitability indicators that BLOs used were gross and net profit margins. There was evidence that BLOs appreciated the distinction between profits generated from continuing operations and extraordinary items. To this extent McMonnies' recommendations, which are reflected to a great extent in FRS 3, would be seen as sympathetic to the needs of BLOs.

BLOs attempted to gain an understanding of the objectives of the loan applicant to assess the purpose of the loan. However, there was no evidence of monitoring these objectives. Forecasts and plans when supplied by the loan applicants were used in assessing the application. These primarily consisted of cash flow forecasts on a monthly basis for one or two years. When information was not supplied voluntarily it seems that BLOs did not specifically request the information. The authors suggest that more emphasis is given by BLOs to asset-values rather than to forecasts. This suggests that the banks are more concerned with security than the future cash generating ability of the business.

The paper concludes that although BLOs say they generally require an expanded information set within the framework of the financial reports, it was questionable as to the extent to which it would actually be used. It was found that the assessment of applications was much more impressionistic than analytical.

In terms of cash flow statements, McMonnies' recommendations have since been adopted through the Accounting Standards Board introduction of Financial Reporting Statement 1 (FRS 1) in 1991. McMonnies dismisses historic cost valuations of assets in favor of net realizable value. McMonnies' definition of net realizable value is – an estimate of the amount the business would receive if an asset was sold, in an orderly fashion vis-à-vis in a liquidation. The majority of the recommendations with regard to disclosure of profits have now been included in Financial

Reporting Statement 3 introduced in 1992. A statement of corporate objectives is recommended so that performance can be judged in terms of the attainment of these objectives. In the case of forecast information, McMonnies recommends that a strategic plan and estimates of future cash flow should be disclosed. Disclosure of market, the rate of growth and other economic information that affects companies within their environment is recommended. From the perspective of human resource accounting, McMonnies advocates disclosure of information related to the experience and accountability of influential officers to the company.

Evidence from the study indicates that when a BLO examined the assets o an applicant's business their aim was to estimate the current value of the asset if it was sold; that is, the asset's realizable value. It seems that often, crude measures were used in attempting to determine the realizable value of assets. Buildings, plant and machinery and stocks were often the subject of a discount multiplier. For example, one respondent used a multiple of 0.1 on stock and machinery.

The relevance of cash flow information for predicting bankruptcy was highlighted by Beaver (1966). Beaver (1966) reported that cash flow from operations (CFFO), proxied by net income plus depreciation, depletion and amortization, to total debt had the lowest misclassification error relative to common accrual measures of financial health. However, his univariate approach to analyzing financial distress was seldom followed because while one ratio would indicate failure another could indicate nonfailure. Altman (1968) overcame this problem through the use of multiple discriminant analysis (MDA) that simultaneously considers financial ratio indicators of corporate health. Altman (1968) did not examine the value of cash flow information though. Deakin (1972) demonstrated employing MDA that cash flow to total debt was a significant predictor up to three years prior to failure. However, the role of cash flow information in discriminating between bankrupt and non-bankrupt companies remains a contentious issue.

The study of Bamber et al (1997) provides evidence on the effect of the modified audit report on bank loan officers lending decisions. The results reveal a consistent pattern of effects for the uncertainty-modified audit report. When the loan application included a modified audit report, bank loan officers gave the loan application a higher risk assessment and a higher interest rate premium. They were also less likely to grant the loan. Rather than simply causing bank loan officers to give greater weight to the uncertainty disclosed in the financial statements accompanying the loan application, bank loan officers attached greater weight to the audit report itself when it contained the explanatory fourth paragraph. These suggest that the uncertainty-modified audit report conveys information to bank loan officers.

The study's significant experimental results are consistent with a research survey (Miller et al 1993) that suggests that the expectation gap standards have helped clarify the nature of the auditor's communication with financial statement users. These results do not support the rationale for SAS No. 79 that the modified audit report is redundant because the footnotes to the financial statements already contain the same disclosures as in the audit report's explanatory fourth paragraph. Rather, the results support the argument that the auditor's additional disclosure of the uncertainty is informative, providing an independent, informed second opinion about the importance of the uncertainty. Eliminating this reporting option appears to be a questionable step, if the profession's objective is to maximize auditing contribution to financial reporting.

Matata Munyeke (1996) concludes that the client's failure to supply audited or management accounts to the bank makes the monitoring exercise frustrating and even fruitless. Therefore officers may not notice early enough any failing projects. He summarizes the following as the possible causes of poor investment portfolio of Development Financial Institutions:

- Engagement in risky business
- Over emphasis of developmental role
- Oversights by officers during the appraisal process
- Corruption
- Undue influence by promoters during the appraisal process
- Weak research departments
- Delays in project realization
- Impediments in the monitoring exercise
- Failure to identify symptoms of failing projects

- Inefficient management of the project
- Unfavorable or adverse government policies and government interferences
- Insufficient raw materials
- Lack of generous dividend policy

Mucheke (2001) in his project on Factors Contributing to Non-Performing Loans concluded that the following factors contributed to non-performing loans:

- Weak internal environment such as inadequate credit policy.
- The government's macro economic policy, which ultimately determine how the economy performs.
- Poorly managed and unprofessionally run businesses.

There are two aspects of the lending process-loan evaluation and loan monitoring. The literature tends to emphasize loan evaluation but also provides clear evidence of the additional need for loan recipients to make regular submission of financial data after the loan has been agreed. There is some discussion of the extent to which banks use the opportunity provided by the granting of loan to require the future provision of data either currently unavailable or not provided at the time of the original loan application.

Otieno (et al 1999) investigated the use made of financial statements by Zimbabwean loan officers. The results of the study showed that loan managers:

- Use information derived from financial statements on their lending decisions
- Do not rely entirely on one source of information
- Would like to make some improvements to annual reports. For example, Cash Flow Statement would be preferred to Funds Flow Statements. The disclosure of both turnover and cost of goods sold should be required by law.

CHAPTER 3: RESEARCH DESIGN

3.1 POPULATION OF THE STUDY

The population is all the banks operating in Kenya under "The Banking Act; Chapter 487". A list of all banks operating in Kenya as at 28th February, 2003 is presented in Appendix III.

3.2 DATA COLLECTION

The study used primary data, which, was collected from a sample of all the commercial banks operating in Kenya.

The respondents for the study were the credit risk analysts of Kenyan commercial banks.

A structured questionnaire consisting of closed-ended questions were used. The questionnaire is presented in appendix II. A letter introducing the candidate to the respondents is presented in appendix I.

The questionnaire was made up of six sections:

Section A	Lending objectives
Section B	Sources of information
Section C	Level of reading of different sections of financial statements
Section D	Additional information to be included in financial statements
Section E	Additional information to be incorporated in the Company's Act.
Section F	Background Information

The opinions or attitudes of the respondents were captured on a four-point scale and the following scheme was used to interpret the responses:

Label	Range of Means
Very Important	3.50-4.00
Moderately Important	2.50-3.49
Slightly Important	1.50-2.49
Not Important	1.00-1.49
For Section C only:	
Read Thoroughly	3.00-4.00
Read Briefly	2.50-3.00
Do Not Read	1.00-2.49

3.3 DATA ANALYSIS TECHNIQUES

The following measures were used in the analysis:

- Means to rank the variables. The initial hypothesis is, the higher the mean the greater the importance of the item. Another representative measure to be used in this study is the mode.
- Standard deviation as a measure of spread among the respondents about the mean (Bowen and Weisberg, 1980).
- Correlation coefficients to identify relationships between lending objectives and sources of information and between the sources.

CHAPTER 4: RESEARCH FINDINGS

4.1 PROFILE OF RESPONDENTS

A total of 34 questionnaire responses were received from 27 banks i.e. 63 percent of all banks. The banks that responded to the questionnaire, however, held 89 percent of net assets of the banking industry (Bank Supervision Annual Report, 2001). The results of the questionnaire responses are shown in tables 4.1-4.7.

Table 4.1 shows the backgrounds of respondents. The respondents were generally well educated (87 percent were either graduates or postgraduates), and experienced (68 percent had more than five years experience in credit) and processed large volumes of loans (62 percent processed over Shs300 million in a year). 85 percent of the respondents were between 26 and 45 years of old. Only 18 percent of the respondents were female, which is likely to be an indicator of representation of women in this field.

4.2 OBJECTIVES OF THE LENDING DECISIONS

As shown in table 4.2 the respondents are generally in agreement about their lending objectives with a standard deviation of less than one in all the categories of objectives. All respondents see profitability as the most important objective with a rating of 3-4. The need to minimize default

Table 4.1 Background of Respondents

Background	Proportion of Respondents
Gender	
Male	82%
Female	18%
Total	100%
Age (Years)	
Under 25	0%
26-35	53%
36-45	32%
46-55	6%
Over 55	9%
Total	100%
Number of years served as loan/credit officer	
Less than 2	12%
3	12%
4	9%
More than 5	68%
Total	100%
Number of applications you process per year	
Less than 50	24%
51-100	24%
101-150	9%
More than 150	44%
Total	100%
Loan amounts you process per year (in value terms-Shs Millions)	
Less than 100	15%
101-300	24%
301-500	15%
More than 500	47%
Total	100%
Which of the following best describes your level of education?	
Secondary	0%
High School	12%
Degree	61%

Postgraduate	27%
Total	100%

risk, with a mean of 3.65 is also highly rated. Adhering to government policy was highly ranked at a mean of 3.35. This is probably explained by the fact that failure to meet government policy requirements such as cash ratio or minimum capital requirements may lead to punitive penalties.

Respondents rated social objectives as only slightly important. This ranking level is characteristic of developing countries where many firms do not place a great amount of emphasis upon social objectives. 15 percent of respondents consider it 'not important'.

These findings are consistent with those of Danos et al.(1989) in the U.S., Berry et al.(1993) in the U.K. and Otieno et al. (1999) in Zimbabwe.

Summaries of Questionnaire Responses

Table 4.2 Lending Objectives

	Mean	Mean Ranking	Standard Deviation	Minimum	Maximum
A-Items 1-5 in the questionnaire represent lending objectives					
1 Minimizing default	3.65	2	0.73	1	4
2 Adhering to government policy	3.35	3	0.95	1	4
3 Profitability	3.76	1	0.43	3	4
4 Social objectives	2.47	5	0.86	1	4
5 Credit Expansion	3.15	4	0.99	1	4

Table 4.3 Sources of Information

	Mean	Mean Ranking	Standard Deviation	Minimum	Maximum
B-Items 6-16 in the questionnaire represent important sources of information					
6 Financial statements	3.85	1	0.36	3	4
7 Customer's bankers	3.32	5	0.81	1	4
8 Customer's employers	2.61	9	0.83	1	4
9 Customer's references	3.06	6	0.89	1	4
10 Customer's records with the lenders	3.82	2	0.46	2	4
11 Customer's project proposal	3.70	4	0.59	2	4
12 Credit rating agencies	2.38	10	1.05	1	4
13 Visit to companies	3.76	3	0.50	2	4
14 Government publications	2.82	7	0.87	1	4
15 Tips and rumors	2.18	11	1.03	1	4
16 Newspapers, magazines and journals	2.77	8	0.86	1	4

Table 4.4 Extent To Which Financial Statements Are Read

	Mean	Mean Ranking	Standard Deviation	Minimum	Maximum
C-Items 17-25 in the questionnaire represent the extent to which parts of financial statements are read					
17 Balance sheet	3.94	2	0.24	3	4
18 Profit & loss account	3.97	1	0.17	3	4
19 Statement of retained earnings	3.59	5	0.70	2	4
20 Cashflow statements	3.82	3	0.46	2	4
21 Notes to accounts	3.56	6	0.66	2	4
22 Director's report	2.85	8	0.86	1	4
23 Statement of accounting policies	3.11	7	0.84	1	4
24 Auditors' report	3.68	4	0.59	2	4
25 Chairman's report	2.65	9	0.85	1	4

Table 4.5 Additional Information To Be Published In Financial Statements

	Mean	Mean Ranking	Standard Deviation	Minimum	Maximum
D-Items 25-42 in the questionnaire relate to additional information to be published in the financial statements					
25 Business of directors	2.74	15	0.99	1	4
26 Total remuneration of directors	2.65	17	0.85	1	4
27 Research and development	2.79	14	0.89	1	4
28 Change in top management	3.68	3	0.53	2	4
29 Brand name	2.88	13	0.91	1	4
30 Sales forecast	3.62	5	0.55	2	4
31 Profit forecast	3.68	4	0.53	2	4
32 Interim report	3.41	7	0.66	2	4
33 Future earnings per share	2.65	18	0.85	1	4
34 Market share	3.35	8	0.77	1	4
35 Segmental reporting	2.94	12	0.81	1	4
36 Actual paid tax	2.68	16	0.77	1	4
37 Company products	3.12	10	0.95	1	4
38 Turnover	3.77	2	0.61	1	4
39 Management audit	3.24	9	0.86	1	4
40 Cost of goods sold	3.44	6	0.71	1	4
41 New product	2.97	11	0.85	1	4
42 Cash flow statements	3.85	1	0.36	3	4

Table 4.6 Additional Information To Be Incorporated In The Company's Act

	Mean	Mean Ranking	Standard Deviation	Minimum	Maximum
E-Items 43-60 in the questionnaire relate to additional information to be incorporated in the Company's Act					
43 Business interest of directors	3.09	7	0.95	1	4
44 Remuneration of directors	2.73	15	0.94	1	4
45 Research and development	2.79	14	0.89	1	4
46 Change in top management	3.39	1	0.75	1	4
47 Brand name	2.88	12	0.93	1	4
48 Sales forecast	3.21	5	1.02	1	4
49 Profit forecast	3.24	4	1.00	1	4
50 Interim reports	3.03	10	0.85	1	4
51 Future earnings per share	2.61	18	1.03	1	4
52 Market share	3.00	11	1.03	1	4
53 Segmental reporting	2.67	17	0.89	1	4
54 Actual tax paid	2.73	16	0.91	1	4
55 Company products	3.06	9	1.06	1	4
56 Turnover	3.33	2	1.11	1	4
57 Management audit	3.15	6	0.97	1	4
58 Cost of goods sold	3.09	8	1.04	1	4
59 New product	2.88	13	0.96	1	4
60 Cash flow statements	3.33	3	1.11	1	4

Table 4.7 Frequency and Mode Value Labels

Value Label	Not Important 1	Slightly Important 2	Moderately Important 3	Very Important 4	Total %	Mode
Section A						
1. Minimizing default	3%	6%	15%	76%	100%	4
2. Adhering to government policy	6%	15%	18%	62%	100%	4
3. Profitability	0%	0%	24%	76%	100%	4
4. Social objectives	15%	32%	44%	9%	100%	3
5. Credit Expansion	9%	15%	29%	47%	100%	4
Section B						
6. Financial statements	0%	0%	15%	85%	100%	4
7. Customer's bankers	3%	12%	35%	50%	100%	4
8. Customer's employers	9%	33%	45%	12%	100%	3
9. Customer's references	3%	26%	32%	38%	100%	4
10. Customer's records with the lenders	0%	3%	12%	85%	100%	4
11. Customer's project proposal	0%	6%	18%	76%	100%	4
12. Credit rating agencies	26%	24%	35%	15%	100%	3
13. Visit to companies	0%	3%	18%	79%	100%	4
14. Government publications	6%	29%	41%	24%	100%	3
15. Tips and rumors	35%	21%	35%	9%	100%	1,3
16. Newspapers, magazines and journals	9%	24%	50%	18%	100%	3

4.3 SOURCES OF INFORMATION

Respondents' opinion on eleven (11) different sources of information was requested. The sources ranged from financial statements to newspapers, magazines and journals.

Financial statements as a source of information was rated as very important by 85 percent of the respondents (See Table 4.3). This information is readily available at low cost. This is consistent with the findings of Danos et al.(1989) in the U.S., Berry et al.(1993) in the U.K. and Otieno et al. (1999) in Zimbabwe.

The second most highly ranked mean, also very important, was customer's record with the lending institution. A customer with a good track record is unlikely to default on the next loan. The cost of using such records is relatively low. However, this source is of no use in the case of first time borrowers.

Also ranked as very important are visit to customer premises and customer project proposal, in that order. On studying a customer's project proposal, the lender can determine the intended use of the funds and the project's viability. One would expect loan managers to visit the business of borrowers to see for themselves what goes on especially for sizeable loans.

Customer's bankers, government publication, magazines (newspapers or journals) and customers employers' were all rated as moderately important in that order. Suggesting that while these are useful sources of information for credit risk analysis, credit risk analysts do not place too much reliance on them.

Credit rating agencies and tips and rumours were only ranked as slightly important in that order. Credit rating agencies are rated very important in the United States, United Kingdom and Zimbabwe (Otieno et al, 1999). It is ranked among the lowest with a mean of 2.38 probably because of lack of legislation to deal with issues of confidentiality of information given to credit rating agencies (Bank Supervision Annual Report, 1999) and the fact that there are no locally based rating agencies in Kenya. Tips and rumours have the lowest ranking suggesting that loan officers rarely use them.

4.4 THE EXTENT TO WHICH SECTIONS OF FINANCIAL STATEMENTS ARE READ

In Section B of the questionnaire responses (see items 6-16 of tables 4.4), it was noted that lenders rely on financial statements in making lending decisions. Financial statements as a source of information were rated as very important by 85.29 percent of the respondents. In Section C (see items 17-25 of tables 4.4) the importance of different parts, which make up annual reports are reviewed. Respondents were asked to state the extent to which they read parts of the annual report. The assumption is that loan managers will read thoroughly those parts they consider informative but ignore those sections with low information content.

Lenders may well use models to predict default. Gibson (1983) shows that these models often use financial statements information. Dietrich and Kaplan (1982) have developed a model designed to replicate the judgement used in classifying loan risk. By identifying the parts, which are thoroughly read, accountants can attempt to meet the information requirements of lenders.

This research indicates that the Profit and Loss Account, Balance Sheet and Cash Flow Statement with a mean of 3.97, 3.94 and 3.82 respectively are read thoroughly, which is consistent with the U.K. evidence, Berry et al. (1991) and the findings in Zimbabwe, Otieno et al. (1999).

The other components of the annual report, namely, the Statement of Accounting Policies, the Notes to the Accounts, the Auditors' Report and the Directors' Report were read only briefly. Berry et al.(1993) found all these components assuming the Statement of Policies to be included in the Notes, to be well used in the United Kingdom.

The standard deviations of the items within this section are also low, suggesting that respondents tend to agree on the extent to which parts of financial statements are read.

Correlation of coefficients between lending objectives and sources of information and between the sources were all below 0.05, indicating no significant relationship.

4.5 ADDITIONAL INFORMATION TO BE INCLUDED IN THE FINANCIAL STATEMENTS

Credit analysts were asked to suggest additional information they wished to have included on financial statements. As shown in Table 4.5 cash flow statement, turnover, change in top management, profit forecast and sales forecast, in that order were all considered to be very important.

4.6 Additional Items To Be Incorporated in the Company's Act

Lenders considered change in top management, cash flow statement, turnover, profit forecast and sales forecast in that order of mean ranking as the most important additional items to be incorporated in the Company's Act (See Table 4.6). All items under this section were rated as being moderately important. Suggesting that there was a general desire to have the Company's Act reviewed to make additional disclosure requirements.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSIONS

The study had three objectives; to establish whether credit risk analysts in Kenyan commercial banks use financial statements in credit risk assessment, to identify the sections of Kenyan annual reports which credit risk analysts find most useful and to find out from credit risk analysts in Kenyan commercial banks improvements that can be made to financial statements.

The study revealed that credit risk analysts use information derived from financial statements in their lending decisions. Financial statements as a source of information were rated as very important by 85 percent of the respondents.

The study showed that credit risk analysts do not rely on only one source of information. Customer records with the lending institutions, visits to customer premises and customer project proposals were also ranked as very important.

Credit risk analysts also indicated that they would like some improvements made to annual reports. For example, the law should require the disclosure of change in top management, cash flow statement, turnover, profit forecast and sales forecast.

These results are expected to be useful both for organizations seeking loan finance and for accounting standards setters. They are also useful as a reference point for comparative studies that might be undertaken in other African countries.

5.2 LIMITATIONS OF STUDY

A limitation of the study stems from its design, which involved the use of a questionnaire to capture relevant information. Personal interviewing, observation or content analysis of credit risk analysts' reports might have obtained richer responses.

5.3 FURTHER RESEARCH

Future research should use in-depth interviewing techniques to provide a more complete picture of how credit risk analysts use financial statements in credit risk assessment in Kenya.

The study found that credit risk analysts use information derived from financial statements in their lending decisions. Further research should be carried out on how each of the financial statements is used.

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Appendix I

LETTER OF INTRODUCTION

UNIVERSITY OF NAIROBI,
DEPARTMENT OF BUSINESS ADMINISTRATION
FACULTY OF COMMERCE,
P.O. BOX 30197,
NAIROBI.

TO WHOM IT MAY CONCERN

Dear Respondent,

Ref: Request for Research Data

I am a postgraduate student at the University of Nairobi, Faculty of Commerce. In partial fulfillment of the requirements for the award of the degree in Master of Business Administration, I am conducting a study entitled; *An Analysis of The Usefulness Of Annual Financial Statements To Credit Risk Analysts In Kenyan Commercial Banks.* Your bank has been selected to participate in this study.

For the purpose of completing my research, I wish to collect data through the attached questionnaire. I shall be grateful if you would kindly assist me by completing this questionnaire.

This information is purely for the purpose of my project work and I pledge to you that it shall be treated with strict confidentiality. A copy of the final research report will be availed to you upon request.

Thank you for your cooperation.

Yours faithfully,

ADAM M. BORU
MBA CANDIDATE

LUTHER OTIENO
LECTURER
DEPARTMENT OF ACCOUNTING
SUPERVISOR

RESEARCH QUESTIONARE

AN ANALYSIS OF THE USEFULNESS OF ANNUAL FINANCIAL STATEMENTS TO CREDIT RISK ANALYSTS IN KENYAN COMMERCIAL BANKS

Please rate the following items in their order of importance by ticking as follows:

1	2	3	4
Not Important	Slightly Important	Moderately Important	Very Important

Section A

Lending objectives?

	1	2	3	4
1. Minimizing default				
2. Adhering to government policy				
3. Profitability				
4. Social objectives				
5. Credit Expansion				

Please rate the following items in their order of importance by ticking as follows:

1	2	3	4
Not Important	Slightly Important	Moderately Important	Very Important

Section B

Sources of information

6. Financial statements
7. Customer's bankers
8. Customer's employers
9. Customer's references
10. Customer's records with the lenders
11. Customer's project proposal
12. Credit rating agencies

13. Visit to companies				
14. Government publications				
15. Tips and rumors				
16. Newspapers, magazines and journals				

Please rate the following items in their order of importance by ticking as follows:

1	2	3	4
Not Important	Slightly Important	Moderately Important	Very Important

Section C

Extent to which parts of financial statements are read

	1	2	3	4
17. Balance sheet				
18. Profit & loss account				
19. Statement of retained earnings				
20. Cashflow statements				
21. Notes to accounts				
22. Director's report				
23. Statement of accounting policies				
24. Auditors' report				
24. Chairman's report				

Please rate the following items in their order of importance by ticking as follows:

1	2	3	4
Not Important	Slightly Important	Moderately Important	Very Important

Section D

Additional information to be published in the financial statements

25. Business of directors	☐	☐	☐	☐
26. Total remuneration of directors	☐	☐	☐	☐
27. Research and development	☐	☐	☐	☐
28. Change in top management	☐	☐	☐	☐
29. Brand name	☐	☐	☐	☐
2. Sales forecast	☐	☐	☐	☐
29. Profit forecast	☐	☐	☐	☐
30. Interim report	☐	☐	☐	☐
31. Future earnings per share	☐	☐	☐	☐

32. Market share	☐	☐	☐	☐
33. Segmental reporting	☐	☐	☐	☐
34. Actual paid tax	☐	☐	☐	☐
35. Company products	☐	☐	☐	☐
36. Turnover	☐	☐	☐	☐
37. Management audit	☐	☐	☐	☐
38. Cost of goods sold	☐	☐	☐	☐
39. New product	☐	☐	☐	☐
40. Cash flow statements	☐	☐	☐	☐

Please rate the following items in their order of importance by ticking as follows:

1	2	3	4
Not Important	Slightly Important	Moderately Important	Very Important

Section E

Additional information to be incorporated into the Company's Act

	1	2	3	4
41. Business interest of directors				
42. Remuneration of directors				
43. Research and development				
44. Change in top management				
45. Brand name				
46. Sales forecast				
47. Profit forecast				
48. Interim reports				
49. Future earnings per share				

50. Market share

51. Segmental reporting

52. Actual tax paid

53. Company products

54. Turnover

55. Management audit

56. Cost of goods sold

57. New product

58. Cash flow statements

Section F

Background Information

Information solicited in this section is useful in general analysis of demographic characteristics of respondents e.g. gender proportion of respondents. All information will be treated with strict confidentiality.

Gender:

Male ☐

Female ☐

Age (Years)

Under 25 ☐

26-35 ☐

36-45 ☐

46-55 ☐

Over 55 ☐

Number of years served as loan/credit officer

Less than 2

3

4

More than 5

Number of applications you process per year

Less than 50

51-100

101-150

More than 150

Loan amounts you process per year (in value terms-Million Kshs.)

Less than 100

101-300

301-500

More than 500

Do you always use companies' published annual reports as a source of information in making lending decision?

Yes ☐

No ☐

How important is the published annual report in evaluating loan application?

Not important ☐

Slightly important ☐

Moderately important ☐

Very important ☐

Which of the following best describes your level of education?

Secondary ☐

High School ☐

Degree ☐

Postgraduate ☐

APPENDIX III

COMMERCIAL BANKS OPERATING IN KENYA AS AT 28.02.2003

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
1. AFRICAN BANKING CORP. LTD Managing Director Mr. Ashraf Savani	46452 NAIROBI	TELEX 22069 FAX 222437	223922 251540/1	ABC Bank Mezzanine Floor Koinange Street ho@abcthebank.co.ke	1.5.1984
2. AKIBA BANK LTD. Executive Director Mr. Dhruv Pandit	49584 NAIROBI	TELEX 22060 FAX 225694	331709 218360/1 249633/4 249670/1/2	Fedha Towers Muindi Mbingu st. Nairobi finance.headoffice@akiba.com	`1.7.1995
3. BANK OF BARODA (K) LTD. Managing Director Mr. T. K. Krishnan	30033 NAIROBI	22250 FAX 254-2- 333089	227869 228405	Tom Mboya Street barodak_ho@form-net.com	1.7.1953
4. BANK OF INDIA Managing Director Mr. P.A. Kalyanasunder	30246 NAIROBI	TELEX 22725 FAX 229462	221414-7 218063 218871	Kenyatta Avenue boi10@calva.com	5.6.1953
5. BARCLAYS BANK OF KENYA LTD. Managing Director Mr. Adan Mohamed	30120 NAIROBI	TELEX 22210 FAX 213915	332230	Barclays Plaza Loita Street bbkfin@user.africanline.co.ke	`1.7.1925

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
6. CFC BANK LIMITED Converted to a commercial bank in 1995 Managing Director Mr. Robert Barry	72833 NAIROBI	22814 FAX 223032	340091 741861	CFC Centre Chiromo road Westlands	14.05.55
7. CHASE BANK (KENYA) LTD. (changed name from United Bank Ltd w.e.f 15.11.95) Managing Director Mr. Zafrullah Khan	64042 NAIROBI	TELEX 23152 FAX 246334	244035 245611 330222 252385	Prudential Ass. Building 6th Floor. Wabera Street info@chasebank.co.ke	1.4.1991
10. CHARTERHOUSE BANK LTD. (changed name from Middle East Bank (K) Finance w.e.f, 11.11.96 and became a bank w.e.f. 01.10.98) Managing Director Mr. Sanjay Shah	43252 NAIROBI	23041 FAX 219058 223060	242246/53	Longonot Place 6th. Floor Kijabe Street info@chaterhouse-bank.com	1.10.98
11. CITIBANK N.A. General Manager Mr. Terry Davidson	30711 NAIROBI	22411 22432 FAX 714810/1	711221 222248	Citibank House Upper Hill Road -	1.7.1974
12. CITY FINANCE BANK LTD. Managing Director - S.V. Ramani	22741 NAIROBI	22037 FAX 335386	224238-9 210338/9	Unity House Koinange St. cfbl@saamnet.com	10.09.1984
13. COMMERCIAL BANK OF AFRICA LTD. Managing Director Mr. Isaac Awuondo	30437 NAIROBI	23115 FAX 335827	228881 340200	Wabera Street cba@cba.co.ke	13.2.1967

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
14. CONSOLIDATED BANK OF KENYA LTD. Managing Director Mr. K.A.K. Bett	51133 NAIROBI	22482 FAX 340213	340551 340830 340920	Consolidated Bank Hse. Koinange Street consobank@iconnect.co.ke	18.12.1989
15. CO-OPERATIVE BANK OF KENYA LTD. Managing Director Mr. Gideon M. Muriuki	48231 NAIROBI	22938 FAX 226437 246635	228453/7 210653/4 226231 251290/9	New Location-(H.Q) CO-OPERATIVE HOUSE coopbankmd@form-net.com	1.7.1968
16. CO-OPERATIVE MERCHANT BANK Managing Director Mr. Gideon M. Muriuki	48231 NAIROBI	22938 FAX 219821	228711/2/3	New Location-(H.Q) International Life House Mama Ngina Street cmb@africaonline.co.ke	1.3.1992
17 CREDIT AGRICOLE INDOSUEZ Previously Bank Indosuez- converted on 5.8.1997 Regional Manager Mr. Jean Marguier	69562 NAIROBI	23091 FAX 214166	211175 210546	Re-Insurance Plaza Taifa Road cai.kenya@ke.ca-indosuez.com	1.1.1998
18. CREDIT BANK LIMITED Managing Director Mr Narendra Kumar Agarwal	61064 NAIROBI	TELEX 23050 FAX 216700	222300 222317 220789 332015	Ground Floor Mercantile Hse Koinange st. cblnbi@creditbankltd.com	14.5.1986
19. DEVELOPMENT BANK OF KENYA LTD. General Manager Mr. J.V. Bosse	30483 NAIROBI	FAX 0254-2-338426 054-2-22662	340426 340478 340416	Finance House Loita Street dbk@africaonline.co.ke	1.5.1995

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
20. DIAMOND TRUST BANK KENYA LTD. (merged with Premier Finance on 01.04.99) Managing Director Mrs. N.M. Devji	61711 NAIROBI	23177 FAX 336836	210988/83 (20 lines) 210985/86	Nation Centre- 8th Floor Kimathi Street user@dtbkenya.co.ke	1.11.94
21. DUBAI BANK KENYA LIMITED (changed name from Mashreq Bank from Apr. 2000) Managing Director Mr. Fredrick Njoroge	11129 NAIROBI	22596 FAX (2) 245242	330562-6	I.C.E.A Building Kenyatta avenue user@dubaibank-kenya.com	11.9.1981
22. EQUATORIAL COMMERCIAL BANK LTD Managing Director Mr. T.N. Khwaja	52467 NAIROBI	23198 FAX 331606	331122/338308 330611/221114	Sasini House Loita street ecd@saamnet.com	20.12.95
21. FIDELITY COMMERCIAL BANK LTD. Managing Director Mr. Sultan Khimji	34886 NAIROBI	FAX 243389	242348 244187	I.P.S Bldng. 7th Floor Kimathi St. customerservice@fidelitybankkenya.com	1.6.1992
22. FINA BANK LIMITED. Managing Director Mr. V.M. Shanbhag	20613 NAIROBI	FAX 254-2 337082	240798 337070 222580	Fina House Kimathi Street banking@finabank.com	13.01.95
23.FIRST AMERICAN BANK OF KENYA LTD. Managing Director Mr. M. Blasetti	30691 NAIROBI	TELEX 22398 FAX 333868 216021/226577	215936/7 (15LINES)	I.C.E.A Building Kenyatta Ave. 6TH&7TH FLOORS fabk@saamnet.com	1987
24. GUARDIAN BANK LIMITED. (Merger with First National Fin. Bank app. on 24-11-98) (Merger with Guilder Int. Bank app. on 31.12.1999) Executive Director Mr. G.H. Bhatt	46983 NAIROBI	23214 FAX 254 (2) 229248	211230 214070	Nation Centre 7th Floor Kimathi Street viewpark@guardian-bank.com	17.12.1992

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
25. GIRO COMMERCIAL BANK LIMITED (Merger with Commerce Bank effective 11-12-98) Managing Director Mr. R.B. Singh	46739 NAIROBI	22013 FAX 336991 210679	330129 339519 216005 330135/7/9	Giro House Kimathi Street gcbl@swiftkenya.com	17.12.1992
26. HABIB BANK A.G. ZURICH (Merger with Habib African Ltd app. on 31.12.1999) Country Manager Mr. I.A Allawala	30584 NAIROBI	TELEX 22982	334984-5	National House Koinange Street habibbank@form-net.com	1.7.1978
27. HABIB BANK LTD. General Manager (Africa Region) Mr. Hamid M. Baig	6906 NAIROBI	TELEX 22238	246613 246641	Exchange Building Koinange Street hblronbi@africaonline.co.ke	2.3.1956
28. IMPERIAL BANK LTD. Managing Director Mr.A.Janmohamed	44905 NAIROBI	FAX 230994 250137	225060 252175/8 25284/5	IPS Building Kimathi Street impbank@iconnect.co.ke	1.11.1992
29. INDUSTRIAL DEVELOPMENT BANK LTD. (Converted to a Commercial Bank on 10.09.98) Managing Director Mr. Lawrence Masaviru	44036 NAIROBI	22339 FAX 334594	337079	National Bank Building Harambee Avenue bizcare@idbkenya.com	1.7.1989
30. INVESTMENTS & MORTGAGES BANK LTD. General Manager Mr. A.V. Chavda	30238 NAIROBI	TELEX 22178 713757/716372	711994-8	I & M Bank House 2nd Ngong Avenue invest@imbank.co.ke	25.5.1980
31. KENYA COMMERCIAL BANK LTD. Managing Director Mr. Gareth A George	53290 NAIROBI	23085 FAX 336422	339441/3 339450/2 339446/9	Kencom House Moi Avenue kcbhq@kcb.co.ke	
32. K-REP BANK LIMITED Managing Director Mr. Kimanthi Mutua	39312 **NAIROBI**	FAX NO. 573178 711645	571511 573169 573236/45/67 **573141/8**	Registry@k-repbank.com Naivasha Road Riruta	25.03.99

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
33. MIDDLE EAST BANK KENYA LTD. Managing Director Ghosh Debdutta	47387 0100 NRB -GPO	23132 MEBANK FAX 336182	723120	Mebank Tower Milimani Road Nairobi mebkenya@nbnet.co.ke	15.12.1980
34. NATIONAL BANK OF KENYA LTD (merged with KENYAC effected on 25.05.99) Managing Director - R.M. Marambii	72866 NAIROBI	25743 FAX 0254-2- 330784	226471-8 339690	National Bank Building Harambee Avenue nbkinfo@swift kenya.com	1.1.1968
35. NATIONAL INDUSTRIAL CREDIT BANK LTD. Managing Director Mr. M. N. Davidson	44599 NAIROBI	25535 NINCKENA 718232	718200	N.I.C. House Masaba Road nic@iconnect.co.ke	17.9.1959
36. PARAMOUNT UNIVERSAL BANK LTD. Merger of Paramount with Universal Bank Managing Director Mr. Ayaz Merali	14001 NAIROBI	FAX 449265	449266-8	Sound Plaza Building Westlands pbl.bank@africaonline.co.ke	1.101993
37. PRIME BANK LTD. Managing Director Mr. Vasant K. Shetty	43825 NAIROBI	23224 FAX 334549	211979 214869/70 334312	Kenindia Hse. Loita Street primebank@form-net.com	1.3.92
38. SOUTHERN CREDIT BANKING CORP. LTD. Merged with Bullion Bank Managing Director Mr. D.A. Shah	66171 NAIROBI	22441 FAX 246309 221338	220939 220948 218622	Off Muranga Road -	1.10.80
39. STANBIC BANK KENYA LIMITED. (changed name from Grindlays Bank w.e.f 1.7.93) Managing Director Mr. P.R. Southey	30550 NAIROBI	25207 22397 FAX 229287 330227	335888	Stanbic Bank Building Kenyatta Ave. stanbic@africaonline.co.ke	9.5.1970
40. STANDARD CHARTERED BANK (K) LTD. Managing Director Allan Christopher M. Low	30003 NAIROBI	TELEX 22209 214086	330200 331210	Stanbank House Moi Avenue mds.office@ke.standardchartered.com	1.10.1910

NAME OF INSTITUTION AND CHIEF EXECUTIVE	P.O. BOX	TELEX NO. FAX NO.	TEL. NO.	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED
41. THE DELPHIS BANK LTD. Under CBK Management- Manager Rose Detho Former Managing Director N.R. Panicker	44080 NAIROBI	22493 FAX 219469	228461/2 221875 222076	Finance Hse. Koinange St. delphiskenya@connect.co.ke	02.08.91
42. TRANS - NATIONAL BANK LTD. Chief Executive Mr. Dhirendra K. Rana	34353 NAIROBI	TELEX 23231 FAX 339227	224234-6 339201-4 339225 339223	Transnational Plaza Mama Ngina Street tnbl@form-net.com	1.8.1985
43. VICTORIA COMMERCIAL BANK LTD. Managing Director Mr. Yogesh K. Pattni	41114 00100 NAIROBI	TELEX 22471 FAX 220548/241485	225767 228732 228950	Victor Hse. 2nd Floor Kimathi st. user@vicbank.com	1.6.1987

Source: CBK

Appendix IV

Commercial Lending Process