

**THE EFFECT OF CREATIVE ACCOUNTING ON  
SHAREHOLDERS' WEALTH IN LISTED COMPANIES IN KENYA**

**BY**

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## DECLARATION

I declare that this research project is my original work and has not been presented to any University or institution of higher learning for a degree or any other award.

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## **DEDICATION**

This work is dedicated to my parents; Nyaguthie and Munene and my brothers Muriithi and Mugeru. I also dedicate this work to Mr. Felix and Titus for their unwavering support and encouragement all through in my academic drive. I also dedicate this work to IBVM Loreto sisters and Vincentian priests for their moral and spiritual support, have done a great deal in me reaching this far. May the Almighty God bless you abundantly. Many thanks.

## ABSTRACT

The creative accounting practices are prevalent and attributed to bad corporate governance. Accountants apply strategies that enhance creative accounting by using profit eroding mechanisms which lead to drastic consequences. These include corporate scandals and collapse both international and locally as in the case of WorldCom and Enron. In Kenya, there are companies that over-report their financial performance to meet targets and please ever demanding shareholders. This highlights the existence of creative accounting. The current trend in the Kenyan investment is that companies indicating an increase in shareholders wealth attract more investment and thus increasing share capital. Various methods can be used to influence shareholders wealth as a way of attracting future investment; some may be legal or illegal. This study used a diverse research design; cross-sectional and explanatory research designs were adopted for primary data and time-series for collecting secondary data. This study therefore adopted mixed research design to ensure that the data collected and analyzed addresses the objectives of the study. The study comprised 64 companies listed on the NSE. The target population was comprised of all listed companies in Kenya. 35 questionnaires were distributed for this study but only 25 respondents provided their responses on time thus getting 71.4% response rate. The data was measured using frequency tables, weighted means, standard deviations and percentages and depicted using tables and bar charts as shown in the following sections. The period of study was from 2010 to 2015. The period acted as a pointer with regard to the recent financial crises. The researcher found that the independent variables explain 64.3% of the variance in the shareholders wealth. It's very clear that these independent variables influence to a large extent the growth of shareholders wealth. It is therefore sufficiently to conclude that these variables significantly influence the growth of shareholders wealth given the unexplained variance is only 35.7%. The study recommends that local investors should embrace shareholder value concept as an excellent model for value creation to increase insider trading meant to boost investor confidence and sense of security as guaranteed by mutual interests in growth in shareholder value. Further research should be carried out on other employees who could be involved in creative accounting therefore indirectly affecting shareholders wealth.

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## **LIST OF ABBREVIATIONS**

CEO-	Chief Executive Officer
CMA-	Capital Markets Authority
DPS-	Dividends per Share
EPS -	Earnings per Share
GAAP-	General Auditing and Accounting Principles
IAS-	International Accounting Standards
IASB-	International Accounting Standard Board
IFRS-	International Financial Reporting Standards
IMF-	International Monetary Fund
NSE-	Nairobi Stock Exchange
ROA-	Return on Assets
ROE-	Return on Equity

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

According to International Accounting Standard Board (IASB, 2007 a), for users of financial report to make economic decisions, financial reports must provide useful information. This information can only be useful if it fulfills basic qualitative characteristics of financial statements. The International Accounting Standard Board (IASB, 2007 b) Framework emphasizes that relevant financial information should be predictive or confirmatory in nature. This should be such that the financial information of a specific entity will be considered material when its omission influences economic decision of its users. The managers are entrusted to take care and grow the shareholders' wealth. Salome, (2012), explains that information asymmetry creates agency conflict between management and shareholders as explained the agency theory. Accountants, who are stewards of shareholders, collaborate with directors in manipulating accounting figures rather than showing a true and fair view of financial accounts.

A need therefore arises to identify creative accounting practices, how they are practiced, as well as looking at the effect they have on shareholders' wealth. According to Maria et al., (2013), the anticipations of a company becoming reality, a great need to generate trust with an accurate image reinforces a feeling that such a company practicing transparency is safe. The freedom of decisions allowed by most accounting regulatory bodies are characterized by inadequacy of accounting regulations, their heterogeneity and the evolving process of harmonization encourage an increase in creative accounting

practices. They also emphasized that creative accounting and fraud are practiced when enterprises face financial difficulties and are motivated by the desire to deceive. These practices will disappear only with the fading of their primary causes. The accounting regulators in charge of limiting practices of creative accounting should consider circumstances that allow its practices. There are people who are trying to minimize the impact on the system set up despite the number of standards and frameworks set up by the accounting profession.

Studies carried out internationally and locally indicate the existence of creative accounting in companies. Ozkaya,(2014) studied creative accounting practices in the Turkish government specifically in the public sector. These practices manifested in hidden debts affecting IMF's stabilization programme forecasts. Ogiedu and Odia,(2013) stated that in Nigeria the creative accounting practices are prevalent and attributed to bad corporate governance. Salome,(2012) studied strategies used by accountants in Nigeria to practice creative accounting and found out that they use profit eroding mechanisms which lead to drastic consequences like corporate scandals and collapse both international and locally as in the case of WorldCom and Enron. In Kenya, there are companies that over-report their financial performance to meet targets and please ever demanding shareholders. This highlights the existence of creative accounting. According to Kamau et al.,(2012), this trend has now more than ever ensures that financial statements are sternly scrutinized. Nyabuti et al.,(2015), discovered robust association between the variables (creative accounting and financial performance) among listed companies in Kenya. Most companies use creative accounting practices abusively.

### **1.1.1 Creative Accounting Concept**

According to Kamau et al.,(2015) creative accounting is modification of accounting figures to what the organizations managers and directors desire by exploiting the loopholes of accounting rules that exist as well as overlooking some rules. This is usually displayed by window dressing and off-balance sheet financing. Excessive practice of creative accounting has contributed to corporate failure to firms worldwide. Creative accounting is practiced by various companies in the world including Kenya. They also defined creative accounting as managing of earnings, smoothing of incomes and earnings, aggressive accounting, use of financial engineering techniques, accounting manipulations and enhancing accounts. They stated that there are well-known regulatory changes which constrain aggressive financial reporting despite its continued practice. This raises concern to practitioners, accounting supervisory bodies and those who set standard about the success of these reforms. Their study revealed that the level of firm's independence and autonomy is influenced by the degree of creative accounting.

Apedzan et al.,(2014), States that earnings management means modifying of financial disclosures with the motive of private gain done through involvement in the process of external financial reporting. It takes the form of smoothing of earnings, antagonistic smoothing of incomes and distortion of financials. Shah, (2011) further explained creative accounting as the intentional influence exerted on financial reported figures to suit the impression of managers to stakeholders by a view other than the actual performance or financial position of the company by applying accounting knowledge and discretion within the jurisdiction of laws set up by accounting regulatory bodies.

According to Odia and Ogiedu,(2013), Creative accounting is a way used by professionals to make companies competitive in their business environments by coming up with creative ideas and deducing opportunities to their advantage portraying imprudence often. It is affected by factors such as integrity, moral values and sense of decision, confidence, training and discipline of the accountants, who are key role players, hence considered an ethical issue. Some of the opportunities used by firms for creative accounting include use accounting estimates, principles and choices allowed by accounting rules and exploit loopholes in the accounting regulations. Creative accounting is also manifested through manipulation of the balance sheet, managing of resulting from adjustments in accounting policies or methods, cost capitalizing, structuring of ownership, cash flows, leasing and transactions of converting loans into securities, “big bath” restructure costs, imaginative acquisitions accounting or misuse of materiality concept to validate in accuracy.

According to Nyabuti et al.,(2015), avoidance of tax, acceleration of depreciation and smoothing of incomes are major indicators of practices of creative accounting in Kenya. They pointed out on the need to strengthen enforcement and monitoring mechanisms set up by professional accounting bodies to heighten the qualitative nature of financial reports while reconstructing and sustaining the cautionary confidence of financial investors, shareholders and stakeholders. Avoidance and evasion of taxes are cited as foremost incentives driving creative practices in accounting in Kenya. Tax calculations are based on income, companies understate their income to reduce tax burden by applying their discretion on the choice of methods in accounting to be applied. The study

revealed that a due diligence audit discovered creative accounting practice through omission of a number of transactions from the financial statements, a case of African Petroleum PLC that was slated for privatization in 2001.

### **1.1.2 Shareholders' Wealth**

Shareholder wealth maximization currently has been a focus for all companies as a precedence among other corporate issues like corporate social responsibilities. Adaramola and Oyerinde,(2014), defined shareholder wealth as the projected future earnings to the firm owners calculated in their present value. These earnings usually are in the form of dividends disbursed periodically and proceeds from the trading of stock. They also highlighted that dividends are paid to ordinary shareholders or stockholders out of corporate profits. In their study carried out on listed companies in Nigeria, it revealed that changes in dividend payment could be used to predict stock price movement which consequently affects shareholders wealth. This financial information is extractable from the profit and loss account. Further, they revealed that movement in company earnings influence movement in share prices; financial accounting information on cash flows has a positive impact on share prices which consequently affect shareholders' wealth. However, share prices are dependent on stability and growth of the economy.

According to Oderoet al.,(2012), Creation and maximization of shareholder wealth is the new paradigm of corporates and main objective of companies currently. Capitalism dictates the responsibility of generating and maximizing of shareholders' wealth. Shareholders' wealth is valued using the stock price having put into consideration the

timing and risk associated with future earnings to be received by the shareholders. They pointed that shareholders' wealth can also be measured in other forms such as Return on Equity, Return on Assets and the efficiency ratios. Shareholders' wealth depends on various factors such as methods used to value stock and methods of disbursing payments.

Apedzan et al., 2014, emphasizes that a more varying earnings prospect is incapable of supporting a higher level of dividends as compared to a stable earnings stream. Fluctuating earnings influence investors' capitalization rates and display total riskiness of the firm. They in turn affect subjective prospects of the investors for possible outcomes of future earnings and dividends and also affect the value of the shares of the firm. Under conditions of uncertainty, the theory of market equilibrium confirms that smoothing of incomes indicates an intentional attempt to decrease covariance of anticipated returns with returns on portfolio of the market by offsetting the cyclical reported earnings of a firm.

According to Johannes,(2014), Companies report earnings quarterly and this brought about pressure on management to deliver acceptable earnings per share performance. Recent corporate scandals have been attributed to managers' over-emphasis on short-term EPS performance. EPS growth is determined by incomes retained in reserves, loan liabilities, operating leverage and financial leverage. It undergirds decisions on valuation of share, incentive schemes based on performance of managers and negotiations regarding mergers and acquisitions. Big share price movements are driven by short-term earnings in response to earnings surprises, an objection to the perception of long-term



cash flow expectations driving the share price changes. The recent corporate scandals resulted from fixated earnings which affected stock market allocation thus companies must strategize to maximize projected future value at the expense of lesser short term incomes. EPS is unreliable because of the following factors failure of EPS to reflect creation of shareholders' value, management of earnings and an integral prejudice towards optimistic EPS growth.

### **1.1.3 The Relationship between Creative Accounting and Shareholders' Wealth**

Practices of creative accounting has facilitated many companies beyond financial crises than put them into crisis. The fault when it emerges lies with the user of the financial information. A study carried in India by Shah et al.,(2011) clearly showed how creative accounting was used to by companies producing cement during financial crises in the country. Many companies used the creative accounting techniques to remain afloat. Companies showed profits or minimized losses by change of depreciation policy when demand and production of cement was low. This kept investors reasonably comforted and staff relaxed by paying out dividends out of the profits. Shareholders' wealth was increased as per the reported profits. Even when demand and production increased they did not change the accounting policy.

Creative accounting practices have only short term benefits and at the end results in scandals. Fizza and Malik,(2015), described the manipulative behaviors of users of financial information and how the practices of creative accounting could be of benefit to them or as well lead them into crisis. In macro manipulation policy makers start

convincing others to reject new rules that maybe unfavorable to them thus increasing the risk of investor which eventually result to loss. In micro manipulation the accountants conceal the true outcomes from individual stakeholders to keep them away from a bad corporate image. Manipulation in financial reports benefits only in the short run as it may affect the price of share and capital market of firm. They suggested that companies take up actions which will fill the gaps in decisions of management and accounting regulations, to ensure the financial reports are based on the actual financial position. This is because investors may take a long term decision with the goal of profits at a forthcoming date, or may intend to capitalize on their wealth by a transaction of trading with their stocks; a fact dependent on decision making which is influenced by the financial report. When decisions that do not always benefit the company immediately are made, the business strategies applied prioritize creating wealth for shareholders to maximize their wealth. The board members must be cautious to maintain satisfaction of shareholders.

#### **1.1.4 The Nairobi Stock Exchange**

Recently the NSE has generated billions in new wealth for shareholders. Value growth has been reported highest in underwriting segments. According to an analysis in the Daily Nation Newspaper column, the investor wealth in NSE is growing driven by the gain on blue chip stocks and increasing interest from foreign investors. Local investors have embraced shareholder value concept as an excellent model for value creation. There is also increased insider trading meant to boost investor confidence and sense of security as guaranteed by mutual interests in growth in shareholder value. However, there have been

alerts to investors regarding reduced earnings and even losses hence minimizing chances for disbursement of dividends or bonus. This is due to a combination of deteriorating macroeconomic environment and unique challenges attributed to certain firms.

According to Nyabuti et al.,(2015),in Kenya, hard economic times has motivated many companies to exercise creative accounting to increase the shareholders' wealth hence attract current and potential investors into investment. The watchdogs of the accounting profession in the country are reluctant on the creative accounting issues. Stakeholders who use financial information have not professed this practice of creative accounting which has led to ruin of international companies such as Enron and WorldCom. Several companies in Kenya are reportedly faced with allegations of massive fraud and creative accounting. Kamau et al.,(2015), in their study found that many companies are motivated by tax evasion and avoidance to practice creative accounting. Creative accounting practices were confirmed through earnings management across all sectors in the NSE. With this in mind, the researcher intends to find out if the creative practices of accounting like income smoothing have an effect on shareholders' wealth of listed companies in Kenya.

## **1.2 Research Problem**

There are companies that over-report their financial performance to meet targets and please ever demanding shareholders. According to Fizza and Malik,(2015, When decisions that do not always benefit the company immediately are made, the business strategies applied prioritize creating wealth for shareholders to maximize their wealth.

The board members must be cautious to maintain satisfaction of shareholders. Manipulation in financial reports benefits only in the short run hence susceptibility to future corporate collapse and scandals. According to Lekaram,(2014), the managers pursue personal interest at the expense of shareholders. They purpose huge perks, make defective decisions of investment or participate in creative accounting and fraud. This takes no notice of the fact that shareholders are willing to examine the behavior of management. According to Nyabuti et al.,(2015), the current trend in the Kenyan investment is that companies indicating an increase in shareholders wealth attract more investment and thus increasing share capital. Various methods can be used to influence shareholders wealth as a way of attracting future investment; some may be legal or illegal.

Ozkaya,(2014) studied creative accounting practices in the Turkish government specifically in the public sector. The researcher in the current study identified a research gap based on the fact that the study was carried out in the public sector and also it did not indicate its effect on shareholders' wealth. Ogiedu and Odia,(2013) studied the influence of regulatory activities and corporate governance of Accounting Standards in Nigeria. This study is not carried out in the context of the current study and does not indicate the effect of creative accounting on shareholders' wealth. Momani et al.,(2013), investigated the effect of audit ethics on auditors' ability to detect practices of creative accounting in Jordan. Their study was not in the context of the current study and did not show the effect of creative accounting on shareholders' wealth. Maria et a.,(2013) aimed at presenting some methods of motivating, identifying and decreasing manipulation mechanisms in

financial accounting data in Romanian companies. This study was also not in the context of the current study and did not show the effect of creative accounting practices on shareholders' wealth. Salome,(2012) studied the effect of creative accounting on the job performance of accountants in financial reporting statement in Nigeria. Their study was not in the context of the current study and did not show the effect of creative accounting on shareholders' wealth.

Nyabuti et al.,(2015), investigated creative accounting practices in Kenya and their effect on the financial performance of companies listed in the Nairobi Stock Exchange. Their study did not, however, explain the effect of creative accounting on shareholders' wealth. Kamau et al.,(2015) were analyzing creative accounting among companies listed in the Nairobi Stock Exchange.. This study did not explain the effect of creative accounting on shareholders' wealth. Kamau et al.,(2012) carried a study on tax avoidance and evasion as factors influencing creative accounting among companies in Kenya. This study was not carried out in the context of this current study, which is the NSE and did not explain the effect of creative accounting on shareholders' wealth. To meet the identified research gap this research work was carried out to assist the shareholders and other stakeholders by investigating the effect of creative accounting on the shareholders' wealth before making decisions with regard to potential and current investments in Kenyan companies listed on Nairobi Stock Exchange.

### **1.3 Research Objective**

The objective of this research was to establish the effect of creative accounting practices on shareholders' wealth of companies listed at the NSE in Kenya.

#### **1.3.1 Specific objectives**

- i. To establish the effect of income smoothing on shareholders' wealth of companies listed at the NSE in Kenya.
- ii. To determine the effect of accelerated depreciation on shareholders' wealth of companies listed at the NSE in Kenya.
- iii. To state the effect of tax avoidance on shareholders' wealth of companies listed at the NSE in Kenya.

### **1.4 Value of the Study**

Few studies have examined the effect of creative accounting on shareholders' wealth in Kenya despite the scandals related to creative accounting practices in researches carried out in the country. This study was meant to enrich the knowledge of scholars and researchers since the impact of creative accounting on shareholders' wealth has not been carried out in the Kenyan context. This study looked on the accounting standards parts which act as loopholes for creative accounting by providing alternative methods of accounting for example, revenue and cost recognition methods as well as methods of depreciation assets at the company's discretion. This is beneficial to policy makers especially the government and accounting professionals.

The study also established who benefits from creative accounting. This is important for the Capital Market Authorities. It identified how the impact of creative accounting on a company can be minimized; whether it brings good or crises to the company. Therefore this research was beneficial to the economists, the government, the Capital Markets Authority, institutional and individual investors, and the accounting professionals in Kenya. The government as a user of financial statements has been made aware of the motivations behind creative accounting such as tax evasion and avoidance and hence the knowledge may help it inquire the likelihood of manipulation in financial reporting.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter contains the theoretical review, determinants of the dependent variable, empirical studies and the summary of literature review.

#### **2.2 Theoretical Review**

For the accounting profession, creative accounting is a challenge. This profession applies certain accounting treatment which display varying images of an organization because of they are under pressures of the management. Theories can provide the theoretical review on this study. They are:

##### **2.2.1 Agency Theory**

Listed companies are dominated by equity shares and the separation of ownership and control. As a consequence, information exists and motives to practices of creative accounting are accelerated. The management behavior will be self-serving hence the agency problem. The agency theory (Jensen and Meckling, 1976) explains the principal-agent relationship in business and is aimed at resolving conflicts arising thereafter. Lekaram,2014, further explained that it is related to the problems resulting from varying conflicts of interest between a principal and an agent. A principal-agent relationship arises whenever there is separation between ownership and control, that is, the person owning the firm is not the same one managing it. The agency theory can offers a solid background for appreciating creative accounting behavior.



According to Lekaram,(2014), Multiple principals resulting from holding large blocks of shareholding translate the ancient principal agent problem into a new problem of principals of with varying goals. In emerging nations, varying principal-principal goals are an issue of concern as it results to deprivation of minor shareholders and bondholders of their rights. This creates loopholes for managers to pursue their personal interest at the expense of shareholders through purposing huge perks, making erroneous decisions in investment or participating in creative accounting and fraud. The assumption is that shareholders are willing to scrutinize and analyze behavior of management.

Salome (2012), explanation of the application of agency theory on creative accounting indicated that the accountant or auditor must be responsible to the management /stakeholders in presenting of his/her accounts of stewardship of the organization. The management may exploit their managerial positions for personal interests by manipulating disclosures of financial reporting in their own favor. The relevance of agency theory to this research is that accountants collaborate with the directors to manipulate accounting figures in rendering accounts of their stewardship either to increase or decrease the financial statements.

### **2.2.2 The Information Theory**

According to Kamau et al.,(2015), the theory states that there is a possibility of information asymmetry in which the manager has better information about the financial position of the firm than the shareholders and other users. From the informational perspective, the information asymmetry creates a conflict in corporates between

advantaged managers and stakeholders. The assumption is that the accounting disclosures contain information that is valuable and material in nature to stakeholders in providing signals. The accountant has to portray a true and fair view of transactions in the accounting statements. The managers owing to the privileged information and managerial positions take advantage or direct the enterprise into a course suitable to them. They further stated that the efficiency of the secondary trading of debt securities is increased by decreasing information asymmetry regarding a borrower through conservative reporting. Accounting conservatism and accrual accounting can be tolls of creative accounting as they have direct effect on the financial statements as it deals with a doubtful situation in accounting.

Doi,(2011) states that the information theory states that two parties have access to different information in this case managers and shareholders. It is describes behavior that is resultant, in this case the managers choses whether to communicate and method of communication of the financial information and the users of that information must choose how to deduce the signal.

### **2.3 The Determinants of Shareholders' Wealth**

Shareholders' wealth is influenced by various factors like earnings after tax and interest, market forces, the movement in share prices and dividend pay-out policy.

### **2.3.1 Dividend pay-out policy**

According to Garba,(2014), without taxes dividend pay-out has no effect on shareholders' wealth. Given that the effective capital gains rate is lesser than the ordinary personal income tax rate, after introduction of these taxes the wealth of shareholders decline when dividends are paid out. Majanga,(2015) highlights that mostly in finance, the principle of building wealth is founded on the concepts of dividend payouts and increase in share prices. It is evident that when the company pays out a regular dividend and the price of the stock appreciates on the stock market, such that the investor gets capital gains at this point the shareholders' wealth has been maximized. The assumption is that creation of stockholder wealth is the primary objective of most listed companies; therefore existing and potential shareholders focus on maintaining and building of wealth they have invested in a listed company for an economic gain.

Mpinda,(2013), argued that it is necessary for a firm to establish an optimal dividend payout policy that will maximize shareholders' wealth. He emphasized that variations in dividend payout ratio could adversely affect shareholders' wealth since dividends are more than just a means of distributing net profit.

### **2.3.2 Earnings after Tax and Interest**

Mpinda,(2013), highlighted that investors who are determined that a dividend should only be paid if the company has no value-enhancing capital projects to invest in have a long-term perspective in their investment. They stated that net earnings are divided into retained earnings and dividends. Depending on the investors' decisions, the retained

earnings could be reinvested and preserved as a source of long-term funds. However, shareholders usually invest their money with the expectation of benefiting financially therefore distribution of dividends must be done to maximize their wealth.

### **2.3.3 The movement in Share Prices**

According to Johannes,(2014), Big share price movements are driven by short-term earnings in response to earnings surprises, an objection to the perception of long-term cash flow expectations driving the share price changes.

### **2.3.4. Market Forces**

Adaramol, (2014), a rise and fall in corporation's market value depend basically on market forces. Where the companies and economy portrays likelihood of stability and growth the share prices have a tendency to rise or stabilize. A stock market crash results from economic recession, depression or financial crises.

Hemadivya,(2013) stated that demand and supply factors influence the price of equity shares .Where prices move up when more people start purchasing the shares and if more of them start selling their shares prices go down. He further said that in primary and secondary markets demand behavior is influenced by government policies, firms' and industry performance and potentials. The market share price is one of the principal factors which affect investment decisions of investors. Stock prices change due to market forces.

## **2.4 Empirical Review**

The existence of earnings management as a form of creative accounting is evident in prior studies both locally and internationally. Kamau et al.,(2015) were analyzing creative accounting among listed companies in the Nairobi Stock Exchange in Kenya. Their study comprised 64 companies listed on the NSE. They selected a sample of 39 firms for their survey. Data was analyzed on the basis of modified Jones model to estimate discretionary accruals in various sectors. The study concluded that there were significant variances in discretionary accruals for various sectors. It was evident that there is a high probability that creative accounting could be happening within the sectors. Telecommunication and technology sectors showed the highest probability of creative accounting practices while automobile and accessories sector indicated lowest likelihood of the practices. It confirmed the practices through earnings management across all the sectors for firms listed in the Nairobi Stock Exchange.

Nyabuti et al.,(2015), investigated creative accounting practices in Kenya and their effect on the financial performance of companies listed in the Nairobi Stock Exchange. They used a sample of 30 companies using purposive sampling. Their study took into consideration avoidance of tax, accelerating of depreciation and smoothing of incomes as part of the key creative accounting practices among publicly listed firms in Kenya. They found out that a strong relationship exists between the variables (creative accounting and financial performance) among listed companies in Kenya. They also discovered that most companies applied creative accounting practices aggressively leading to their failures and collapse.

Kamau et al., (2012) carried a study on tax avoidance and evasion as factors influencing creative accounting among companies in Kenya. They highlighted that creative accounting is cosmetic, it give the impression that the company is financially stronger or weaker depending on the aspirations of managers. This practice is unethical in accounting according to the standards of Kenya though some countries' allow it by law. According to their study, practice of creative accounting among companies in Kenya is widely driven by tax avoidance and evasion. They collected data randomly and analyze it from thirty six accountants who act as stewards of various companies in Kenya. This study called for accounting regulatory bodies to heighten their grip on rules of financial reporting to reduce or inhibit creative accounting practices in Kenya. It was found that companies devalue their income to minimize the tax burden imposed on them.

A study by Ozkaya,(2014), focused on creative accounting practices of government by measuring hidden debts of the Turkish public sector during the period 1989 to 2010. In the public sector when the budget is not transparent, a fiscal rule is usually imposed to generate hidden deficits and /or debts. At the late 90s, Turkish public authorities misled IMF with regard to the extent of public debt stock; this eventually led to failure of the planned IMF's fiscal consolidation at the beginning of 2000-2001 crises. The study further highlighted that the fluctuations associated with boom-bust cycles in international capital flows result from the persistent hidden liabilities influencing structures of emerging markets with open capital. The study showed governments can cheat and depress standard databases from incorporating their debt history. It was discovered that political instruments are used by the public sector in generating contingent liabilities and

building special laws with regard to budgets hiding the deficits. The research showed that the stabilization programme 1999 of IMF through its first and third pillar was adversely affected by the extent of hidden debts and liabilities.

Ogiedu and Odia,(2013), dealt with the impact of corporate governance and regulatory activities of Nigerian Accounting Standards on creative accounting practices in Nigeria. Their study showed existence of these practices and a negative influence on the relationship between the variables (the corporate governance and regulatory activities of Nigerian Accounting Standards and creative accounting practices) . The population comprised parties concerned with accountants, users of financial information and regulatory agencies in Nigeria. The response rate of the study was 59%. They stated that creative accounting has some positive indicators for example smoothing of incomes whereas the negative indicators deceive users of companies' reports. Creative accounting practices were attributed to poor corporate governance structures and deficient regulations to check the abuses.

Maria et al.,(2013) , presented some methods of motivating, identifying and decreasing mechanisms of manipulation in financial accounting data. From the study carried out in Romanian companies, conclusions largely confirm and reveal a great need to generate trust with an accurate image reinforces a feeling that such a company practicing transparency is safe. Focus geared towards organization framework and company management must be placed as a measure to curb manipulations in financial statements. They also emphasized that creative accounting and fraud are practiced when enterprises

face financial difficulties and are motivated by the desire to deceive. These practices will disappear only with the fading of their primary causes. The accounting regulators in charge of limiting practices of creative accounting should consider circumstances that allow its practices. There are people who are trying to minimize the impact on the system set up despite the number of standards and frameworks set up by the accounting profession.

Momani et al.,(2013), investigated the effect of audit ethics on auditors' ability to detect practices of creative accounting. Their population consisted 150 auditors selected using simple random sampling method from amid auditors practicing in Jordan. They discovered that rules of audit ethics, integrity and objectivity of auditors affected the ability of auditors to perceive creative accounting. The ability of auditors increases as their ability to detect the practices of creative accounting increase.

A study by Salome et al.,(2012) on the effect of creative accounting on the job performance of accountants in reporting financial statement was carried out in Nigeria. Their study identified the accounting strategies aimed at avoiding creative accounting in any of financial dealings. They found out that accountants used profit eroding mechanisms which lead to drastic consequences like corporate scandals and collapse both international and locally as in the case of WorldCom and Enron. They also discovered that managers of not for profit organizations are motivated to manipulate the ratios of reported programme-spending since donors use the ratios to regulate decisions regarding contributions. Creative accounting hinders resources allocation in the neediest area in the



economy. They highlighted the need to scrutinize potential misuse of accounting policy, choice and manipulation of transactions due to the ethical inference of creative accounting. In Nigeria Stock Exchange, forms of creativity in accounting are share price manipulation, profits or accounts misstatements and insider trading, resulting in the recent crash. They pointed out on the need to strengthen enforcement and monitoring mechanisms set up by professional accounting bodies to heighten the qualitative nature of financial reports, at the same time, reconstructing and sustaining the cautionary confidence of financial investors, shareholders and stakeholders.

## **2.5 The Conceptual Framework**

There are factors to be put into consideration that influence the model used in the study of the effect of creative accounting practices on shareholders' wealth. The independent variables are income smoothing, tax avoidance and accelerated depreciation as strategies of creative accounting. The dependent variable is shareholders' wealth. Other factors are the intervening and moderating variables.

Coopers et al.,(2007) defines intervening variables as variables that explains a conceptual device through which the moderating and predictor variables may affect the dependent variable in an observed relationship. Intervening variables are factors that theoretically affect the dependent variable. These variables are hypothetical, that is, are not observable or could not have been measured. Their effects are inferred from the effects of the independent and moderator variables on the observed phenomenon. In this study, the intervening variables are the audit scope and government policies on creative accounting

practices. The audit scope determines to a large extent if the auditor identifies practices of creative accounting. The government policies on creative accounting practices influences the auditor's report based on the audit work carried out and the law enforcement on perpetrators of these practices. This may affect the nature of creative accounting practiced as well as the concealing of the practice which has an effect on the shareholders' wealth.

According to Cooper et al.,(2007) the extraneous variables are in existence that they might affect a given relationship of variables, in this case, the relationship between creative accounting and shareholders' wealth. In this study, the researcher considers the following variables as moderating variables; will ignore them because their impact occur to have a little effect at the core of the problem being investigated.

The moderating variables includes the: International Accounting Standards (IAS), General Auditing and Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). These influence the accounting policies and methods to be employed by the companies in preparing financial statements. These have left companies to their own discretion on the choice of accounting policies and procedures. As a result companies have chosen accounting policies that favour their financial reports and also they change their policies to suit their needs. When faced by financial distress companies change stock valuation methods and depreciation policies, for instance, to minimize losses or report inflated profits to please shareholders and stakeholders. Most companies

take advantage of loopholes in the accounting standards and frameworks to practice creative accounting for their own benefit.

## **2.6 Summary of Literature Review**

In this research, creative accounting is the independent variable while shareholders wealth is the dependent variable. The relationship between the two variables is influenced by other factors like the accounting standards and framework, the auditors' scope and the government policy on creative accounting practices.

Odero et al.,(2012), Capitalism dictates the responsibility of generating and maximizing of shareholders' wealth. Shareholders' wealth is valued using the stock price having put into consideration the timing and risk associated with future earnings to be received by the shareholders. They pointed that shareholders' wealth can also be measured in other forms such as Return on Equity, Return on Assets and the efficiency ratios.

Kamau et al.,(2012), Creative accounting is the cooking of the books, cosmetic accounting or managing of earnings. Ogiedu and Odia,(2013), stated that creative accounting has some positive indicators for example smoothing of incomes whereas the negative indicators deceive users of companies' reports. The agency theory and information theory best suited to explain the effect of creative accounting on shareholders' wealth. Many global and local researches on related studies have not investigated into the effect of shareholders wealth hence the reason for this study.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter contains the research design, population, sample design, data collection methods and data analysis.

#### **3.2 Research Design**

Sanders, (2009) defines research design as a distinct strategy and investigation of a phenomenon adopted to obtain answers to research questions. It is a program of what the researcher will do based on the intended method of data collection and constraints that the researcher will have.

This study used a diverse research design. Specifically, cross-sectional and explanatory research designs was adopted for primary data and time-series for collecting secondary data. According to Caruth,(2013), a mixed research design guarantees richer insights into the phenomenon of the study. Hence information that may be missed out if only one type of design is used will be captured. This study therefore adopted mixed research design to ensure that the data collected and analyzed addresses the objectives of the study.

According to Coopers et al.,(2007) , a cross-sectional design should be intended to collect data once over the same period of time, analyze then report on it. Explanatory research was effectively used in this research, to test hypotheses by measuring relationships between the independent (creative accounting) and dependent

(Shareholders' wealth) variables given that data was analyzed using statistical techniques. Time series was used to collect secondary data from corporate annual reports of the firms filed with Capital Markets Authority in the Nairobi Securities Exchange booklet.

### **3.3 Population**

A population is the aggregate group of elements about which we desire to create some inferences as defined by Coopers et al.,(2014). The study comprised 64 companies listed on the NSE. The sample of this study consisted of thirty five accountants and managers of listed companies in the NSE. The period of study was from 2010 to 2015. The period acted as a pointer with regard to the recent financial crises. The unit of study was managers and accountants who act as agents for shareholders. The researcher administered questionnaires to managers and accountants of the companies.

### **3.4 Sample Design**

A sample size, according to Kothari,(2008), is the number of items taken from the aggregate to create a sample. A sample for study, according to Coopers et al.,(2014), lowers cost, assures greater accuracy of results, enhances speed of data collection and availability of elements of a population. Sampling procedures that are non-probabilistic are preferred because they satisfactorily meet the objectives of sampling as well as being cost and time effective Coopers,(2014). In this study, purposive a sampling method was applied. This is to get key informants (accountants and managers). This is due to the information they hold by virtue of the positions they hold in the companies.

### **3.5 Data Collection**

The study used both primary and secondary data. The main method of data collection was use of structured questionnaires as the primary source of data. The primary data was collected, organized and coded for processing to generate tallies from every response per question. The researcher used secondary data available from the financial data available in the company's annual reports.

### **3.6 Validity and Reliability of Data**

Validity is stated as the extent to which an instrument measures what it is invented to measure to facilitate the process of solving the research problem by the researcher Coopers et al.,(2014). It was ensured through presenting the research tools to the supervisors, who determined whether the instruments represented the concept under study. The expert feedback in form of recommendations will be incorporated in the final instruments.

Reliability deals with the accuracy and precision of a measurement procedure. It is a partial contributor to validity since a tool of measurement may be reliable without being valid. Reliability is the scope to which the data collection techniques or analysis procedures will give rise to findings that are consistent Sanders,(2009). To ensure reliability, the researcher studied the secondary data from the corporate financial reports before the actual research.

### **3.7 Data Analysis**

On completion of data collection, data was checked for completeness after which it was coded. Data was grouped and arranged according to particular research questions. The data was then analyzed by use of descriptive statistics by help of computer software package SPSS and presented by use of tables, bar charts, frequency distribution tables, pie charts and graphs. This is the method provides results that are presentable and reliable Kothari,(2008). The researcher analyzed the financial statements of the selected firms so as to establish the discretionary accruals which are one of the indicators of creative accounting. The researcher carried out a multiple linear regression analysis to test the relationship among the independent variable (creative accounting) on shareholders' wealth of listed companies at the Nairobi Stock Exchange in Kenya. SPSS (Statistical Package for Social sciences was applied in the regression analysis.

#### **3.7.1 Analytical Model**

The analytical model considered by the researcher is a multiple linear regression model as follows:

$$(Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \epsilon)$$

Where:

Y=Earnings after Tax

$\beta_0$ = Alpha coefficient (the value of Y when all X values are zero)

$X_1$ = Tax Avoidance

$X_2$ = Accelerated Depreciation

$X_3$  = Income Smoothing

$\varepsilon$  = error term or stochastic error

Hypothesis testing was used to test statistical significance:

$H_0$ : Creative accounting does not have an effect on shareholders' wealth

$H_1$ : Creative accounting has an effect on shareholders' wealth

The researcher used the t-tests to test the significance of the variables in this relationship.

The researcher compared the t-statistic and the t-critical; where the t-statistic exceeds the t-critical the null hypothesis was rejected. Further the researcher tested the population for normal distribution using the z-test. For a normal distribution, the z-statistic is greater than z-critical.



## **CHAPTER FOUR**

### **DATA ANALYSIS, FINDINGS AND INTERPRETATION**

#### **4.1 Introduction**

This chapter contains data analysis and interpretation of findings. The objective of this study was to examine the effects of creative accounting on shareholders wealth on listed companies in Kenya. The findings were presented as follow:

#### **4.2 Data Findings**

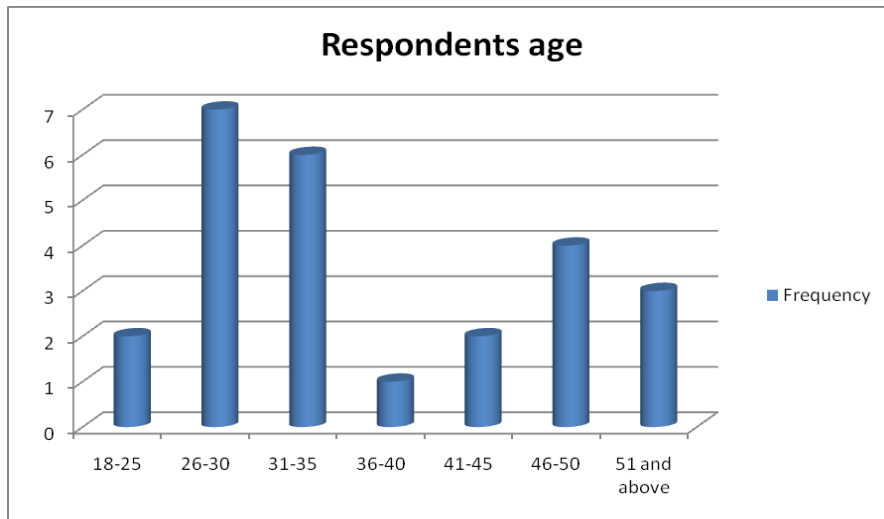
The target population was comprised of all listed companies in Kenya. 35 questionnaires were distributed for this study but only 25 respondents provided their responses on time thus getting 71.4% response rate. According to Coopers et al.,(2014) , response rates vary widely depending on a number of factors such as the relationship with your target audience, survey length and complexity, incentives, and topic of your survey. A response rate of 10-15% is a more conservative and a safer guess if you haven't surveyed your population before. The data was measured using frequency tables, weighted means, standard deviations and percentages and depicted using tables and bar charts as shown in the following sections.

**Table 4.2.1 Respondents age**

<b>Respondents age</b>	<b>Frequency</b>	<b>Percent</b>
18-25	2	8%
26-30	7	28%
31-35	6	24%
36-40	1	4%
41-45	2	8%
46-50	4	16%
51 and above	3	12%

From the analysis of the findings it was found that most of the participants in this study are between 26 and 35 years of age with a rating of 52%. 38% for all respondents involved in this study are above 35 years of age and only 8% are between 18-25 years of age.

**Figure 1: Respondents Age**

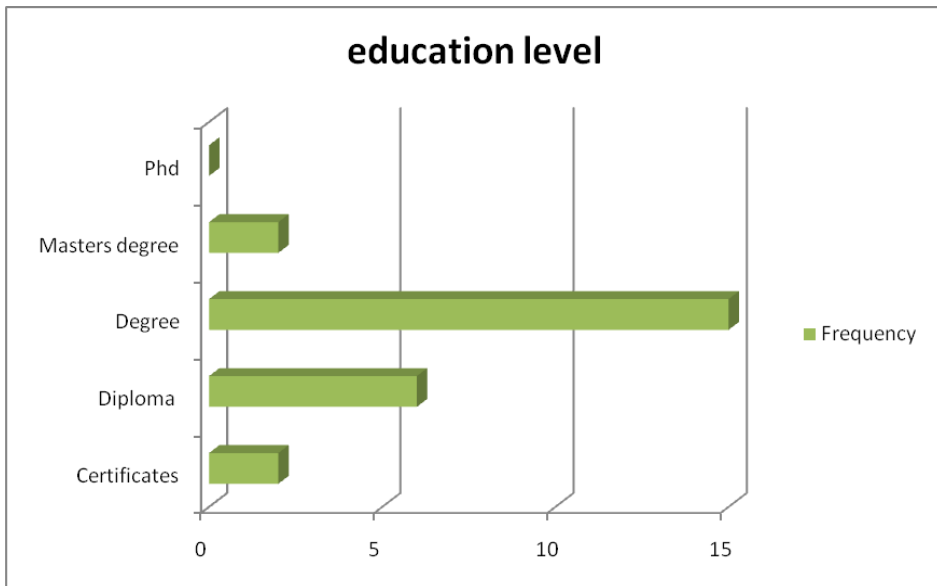


**Table 4.2.2 Education level**

<b>Education level</b>	<b>Frequency</b>	<b>Percent</b>
Certificates	2	8%
Diploma	6	24%
Degree	15	60%
Masters degree	2	8%
PhD	0	0%

From the data analysis concerning the respondents' level of education, it was revealed that most respondents are degree holders with a rating of 60%. 24% of the participants are diploma holders 8% of the sampled respondents are certificate and master holders in level. No respondents with a PhD.

**Figure 2: Educational level**

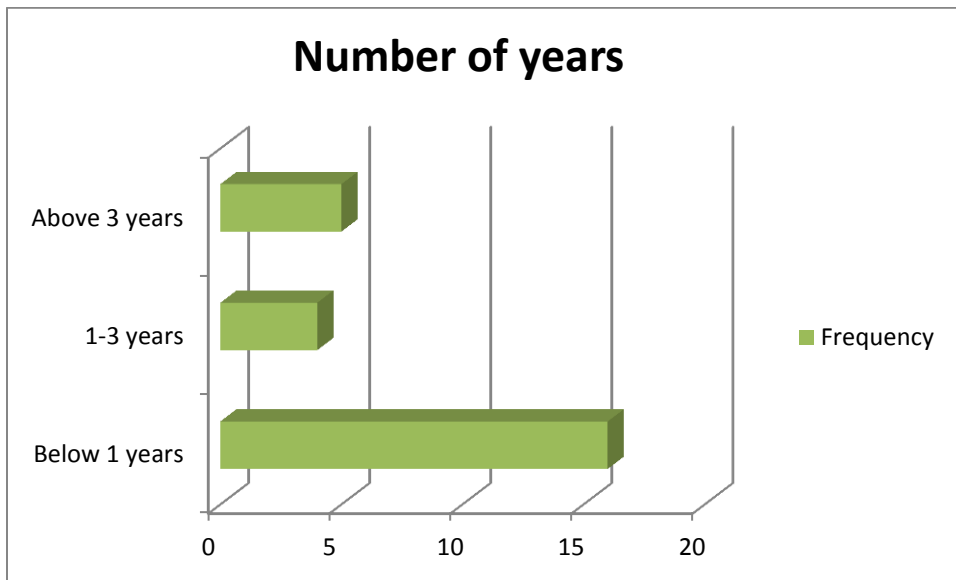


**Table 4.2.3 How long have worked in the organization?**

<b>Number of years</b>	<b>Frequency</b>	<b>Percent</b>
Below 1 years	16	64%
1-3 years	4	16%
Above 3 years	5	20%

From the analysis the responses show that most respondents have been working in their respective organization below 1 year with a rating of 64% and 16 percent have worked between 1 and 3 years. The findings also revealed that 20% of the sampled respondents have worked above 5 years.

**Figure 3: Number of years in the organization**

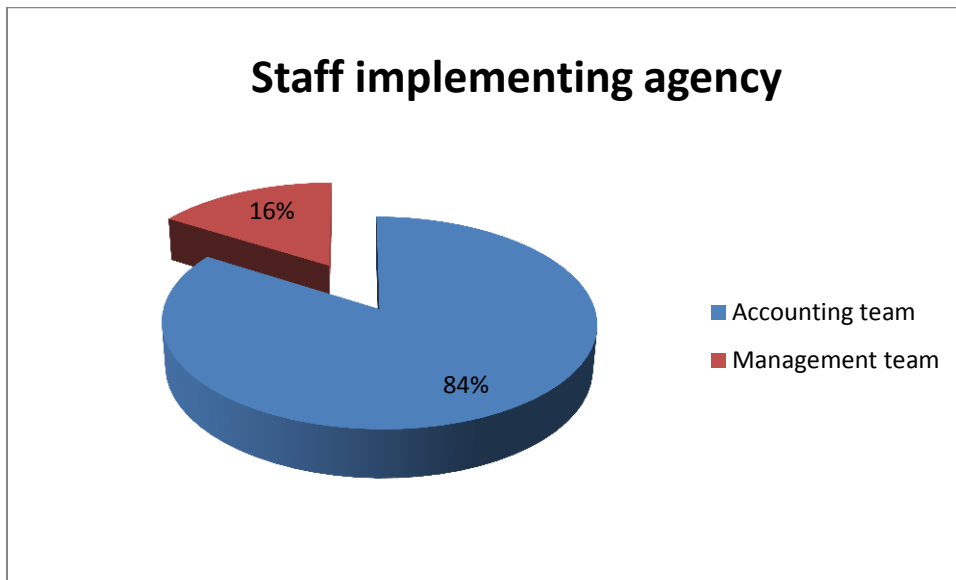


**Table 4.2.4 Staff implementing the agency**

	<b>Frequency</b>	<b>Percent</b>
Accounting team	21	84%
Management team	4	16%

From the analysis of the specific individual involved in the implementation of creative accounting it was found that 84% of the sampled respondents were accountants while management was 16%.

**Figure 4. Staff implementing agency**



**Table 4.2.5 Does the company have a depreciating policy?**

	<b>Frequency</b>	<b>Percent</b>
Yes	22	88%
No	3	12%

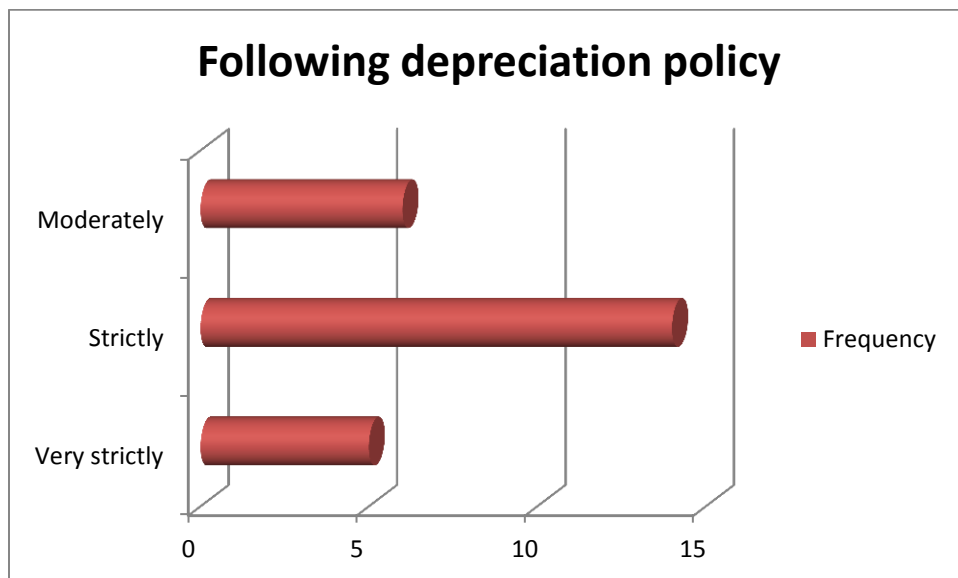
88% of the sampled respondents agreed that their organizations have a depreciation policy applicable to non-current assets while 12% of the respondents have no information on whether their organizations have a depreciation policy.

**Table 4.2.6 How does the company follow the stated depreciating policy?**

	<b>Frequency</b>	<b>Percent</b>
Very strictly	5	20%
Strictly	14	56%
Moderately	6	24%

56% of the sampled respondents confirmed that their organizations follow depreciation policy strictly while 24% stated that their organizations moderately apply depreciation policy regardless. 20% of the respondents agreed that their organizations apply depreciation policy very strictly.

**Figure 5: Following depreciation policy**

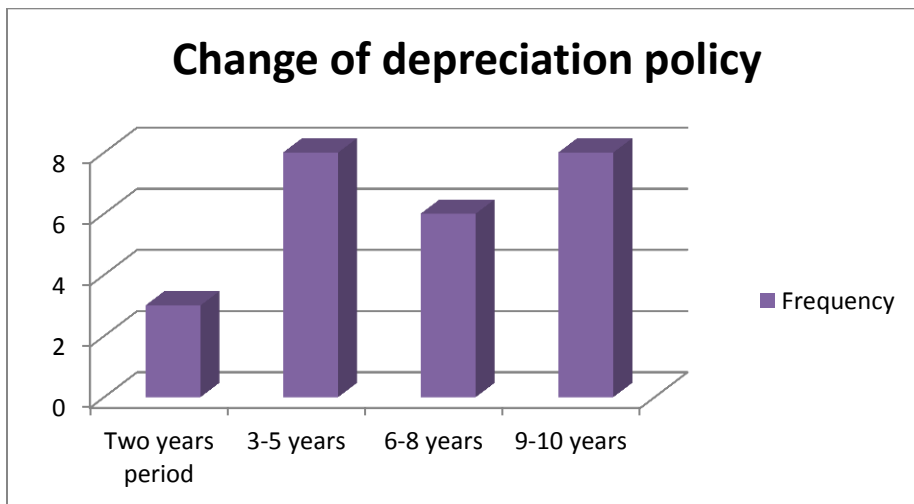


**Table 4.2.7 How often does the method change**

	<b>Frequency</b>	<b>Percent</b>
Two years period	3	12%
3-5 years	8	32%
6-8 years	6	24%
9-10 years	8	32%

32% of the sampled respondents in this study confirmed that their organizations change depreciation policy after every 3 years and 9 years respectively 12% and 24% change their policy after every 2 years and 6 years subsequently.

**Figure 6: Often change depreciation policy**



**Table 4.2.8 What is the dividend payout policy to shareholders out of profits?**

	<b>Frequency</b>	<b>Percent</b>
Constant payout policy	3	12%
Stable dividend policy	16	64%
Residual dividend policy	6	24%

64% of the sampled respondents agreed that their organizations use stable dividend policy when distributing their profits to shareholders with 12% and 24% revealing that their organizations use constant payout policy and residual dividend policy respectively.

**Table 4.2.9 How often does the dividend payout policy change?**

	<b>Frequency</b>	<b>Percent</b>
Very often	2	8%
Often	2	8%
Rarely	21	84%

From the sampled respondents 84% revealed that their organizations rarely change their dividend payout policy while 8% of the respondents agreed that their organizations often and very often change their dividend payout policy.



**Table 4.2.10 Duration considered to change the dividend payout policy?**

	<b>Frequency</b>	<b>Percent</b>
Two years period	2	8%
3-5 years	11	44%
6-8 years	4	16%
9-10 years	8	32%

44% of the sampled participants in this study revealed that between 3 years and 5 years their organizations do change their dividend payout policy while 32% revealed that their organizations do change their dividend policy between 9 years and 10 years.

**Table 4.2.11 Is it good to change the dividend payout policy?**

<b>Number of years</b>	<b>Frequency</b>	<b>Percent</b>
Strongly agree	7	28%
Agree	4	16%
Don't agree	14	56%

56% of the participants in this study revealed that changing dividend policy it's not necessary to organizations with 28% and 16% revealed that changing dividends payout policy it's necessary to organizations.

**Table 4.2.12 How often do you change the bad debts provision?**

<b>Number of years</b>	<b>Frequency</b>	<b>Percent</b>
Two years period	4	16%
3-5 years	7	28%
6-8 years	11	44%
9-10 years	3	12%

From the results it's clear that 44% of the sampled respondents revealed that their organizations do change their bad debts provision between 6 years and 8 years while 28% of the respondents do change their bad debts provision policy between 3 years and 5 years respectively.

**Table 4.2.13 How often have you changed earnings percentage?**

<b>Number of years</b>	<b>Frequency</b>	<b>Percent</b>
Two years period	5	20%
3-5 years	8	32%
6-8 years	9	36%
9-10 years	3	12%

It's clear that 36% and 32% of the sampled respondents revealed that often their organizations do change their earnings percentage between 6 years and 8 years and 3 years and 5 years respectively. 20% of the respondents agreed within 2 years their organizations do change their earnings percentage.

**Table 4.2.14 Model summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.802	.643	0.630	.0122

a. Predictors: (Constant), Tax avoidance, Accelerated depreciation, Income smoothing,

Table 4.3 above indicates that there is an  $R^2$  value of 64.3%. This value indicates that the three independent variables explain 64.3% of the variance in the shareholders wealth. It's very clear that these independent variables influence to a large extent the growth of shareholders wealth. It is therefore sufficiently to conclude that these variables significantly influence the growth of shareholders wealth given the unexplained variance is only 35.7%.

**Table 4.2.15 ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.429	4	2.714	2.714	.001. <sup>a</sup>
	Residual	.000	0	.		
	Total	.429	4			

a. Predictors: (Constant), Tax avoidance, Accelerated depreciation, Income smoothing

b. Dependent Variable: Earnings Per Share

Given 5% level of significance, the numerator df =1 and denominator df =5, critical value

2.74, table 4.2.15 shows computed F value as 2.714.

**Table 4.2.16 Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	.419	.113		2.70 0	.001	.186	.651
Income smoothing 1 (X <sub>1</sub> )	-.265	.098	-.503	-2.7	.012	-.466	-.064
Accelerated depreciation (X <sub>2</sub> )	-.018	.014	-.242	- 1.33	.197	-.046	.010
Tax Avoidance (X <sub>3</sub> )	-.008	.003	-.417	-2.5	.019	-.014	-.001

a. Dependent Variable: Earnings Per Share

### 4.3 Discussions of Research Findings

The research established negative correlation between the variables (income smoothing, accelerated depreciation and tax avoidance) and earnings per share exist. Nyabuti *et al.*,(2015), stated that avoidance of tax, acceleration of depreciation and smoothing of incomes are major indicators of practices of creative accounting in Kenya. This confirms that overall the multiple regression model is statistically significant, in that it is a suitable prediction model for explaining how the selected independent variables affects the shareholders wealth.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter tends to give the summary of the results in this study, conclusions and recommendations for practice and areas for further research.

#### **5.2 Summary**

The objective of this study was to examine the effects of creative accounting on shareholders wealth on listed companies in Kenya. From the analysis of the specific individual involved in the implementation of creative accounting it was found that most of the sampled respondents were accountants. Most of the sampled respondents agreed that their organizations have a depreciation policy applicable their non-current assets while some of the respondents have no information on whether their organizations have a depreciation policy with most confirming that their organizations follow depreciation policy strictly, moderately and very strictly after every 3 years and 9 years with some after every 2 years and 6 years subsequently.

The results also revealed that their organizations use stable dividend policy when distributing their profits to shareholder while some organizations use constant payout policy and residual dividend policy. Some of the organizations rarely change their dividend payout policy while other organizations often and very often change their dividend payout policy between 3 years and 5 years. This study also found that changing dividend policy it's not necessary.

From the results it's clear that most of the sampled respondents revealed that their organizations do change their bad debts provision between 6 years and 8 years while some of the respondents do change their bad debts provision policy between 3 years and 5 years respectively. The results showed that most organizations do change their earnings percentage between 6 years and 8 years and 3 years and 5 years respectively.

### **5.3 Recommendation**

Local investors should embrace shareholder value concept as an excellent model for value creation. This is to increase insider trading meant to boost investor confidence and sense of security as guaranteed by mutual interests in growth in shareholder value. However, there have been alerts to investors regarding reduced earnings and even losses hence minimizing chances for disbursement of dividends or bonus. This is due to a combination of deteriorating macroeconomic environment and unique challenges attributed to certain firms.

The watchdogs of the accounting profession in the country should be strict on the creative accounting issues. Several companies in Kenya are reportedly faced with allegations of massive fraud and creative accounting. This trend must now more than ever ensure that financial statements are sternly scrutinized.

### **5.4 Suggestions for Further Study**

The scope of the current study was limited to the responses of managers and accountants of listed companies in Kenya. Future research could expand other employees who could be practicing creative accounting.

Further, new creative accounting practices may emerge in the future due to changes in regulations, managerial policy and new technologies. Researchers must continue their efforts to identify such emerging issues.

Also, there is need to look into other variables that are affected by creative accounting practices and indirectly affecting shareholders wealth. Further, multivariate statistical analysis should be conducted to identify variables which may have mediating and/ or moderating effects in the relationship between the determinants of shareholders wealth. Further research will shed more light on the long-term implications of creative accounting and its effect on shareholders wealth.

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## APPENDICES

### Appendix 1: Letter of introduction



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Nairobi, Kenya

DATE 15/09/2016

#### TO WHOM IT MAY CONCERN

The bearer of this letter MUHENE JULIA W

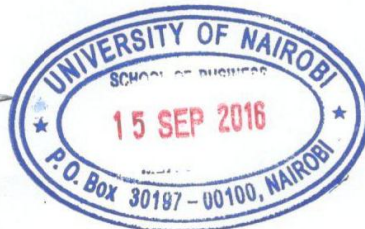
Registration No. D63/72769/2014

is a bona fide continuing student in the Master of Science (Finance) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a finance problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.



**PATRICK NYABUTO**  
**FOR: MSC FINANCE CO-ORDINATOR**  
**SCHOOL OF BUSINESS**

## Appendix II: Questionnaire for the Accounting Staff

This questionnaire is to obtain data on examining effects of creative accounting on shareholders' wealth on listed companies in Kenya.

Please tick where appropriate and give brief explanations where necessary.

### Part A: Personal information

1. Indicate your gender  
Female  Male
2. As a staff of implementing agency, are you on:  
Accounting team  Management team
3. How long have you been a member of staff?  
Less than one year  1-3 years  More than 3 years
4. Level of Education
5. Age of the Respondents  
18-25  26-30  31-35  36-40   
41-45  46-50  51 and above

### Part B: Accelerated Depreciation

6. Does your company have a depreciation policy on assets?  
Yes  No
7. If yes, what is the depreciation policy on the assets of the company?  

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8. If no in (4) above, how do you account for depreciation of the company assets?

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9. We follow the policy/ method above in (5) and (6):

Very strictly  Strictly  Moderately

10. If strictly or moderately, in (7) how often does the policy/method change?

Two years period  3-5years  6-8years  9-10 years

11. Give a reason(s) for your answer in (8) above.

(i)

(ii)

12. Who approves the changes in the depreciation policy or method used?

Accounting team  Management team

### Part C: Income Smoothing

13. As an organization, what is the dividend payout policy to shareholders out of profits?

Constant payout policy

Stable dividend policy

Residual dividend policy

Others (Specify)

(i)

ii)

14. Apart from capitalizing your reserves, what is the company's policy on retained earnings?

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15. How often does the company's dividend payout policy in (12) above change?

Very often

Often

Rarely

16. If often or very often in (13) above, what duration is considered to change the dividend payout policy?

Two years period  3-5years  6-8years  9-10 years

17. In your opinion, is it good for the company to change dividend payout policy?

Strongly agree  Agree  Don't agree

18. Give reason(s) for your answer above

(i)

(ii)

**Part D: Tax Avoidance**

19. What is your company policy on provision for bad debts as a percentage?

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20. In the last 10 years, how often have you changed the policy in (17) above?

Never  Two years period  3-5years  6-8years

9-10 years

21. Give a reason for (18) above:

(i)

(ii)

22. What is the percentage of earnings is capitalized?

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23. In the last 10 years, how often have you changed in (20) above?

Never  Two years period  3-5years  6-8years   
9-10 years

24. Give a reason(s) for (21) above?

(i)

(ii)

*Thank you for taking your time to respond to the questionnaire.*

## Appendix II: Questionnaire for managers.

This questionnaire is to obtain data on examining effects of creative accounting on shareholders' wealth on listed companies in Kenya.

Please tick where appropriate and give brief explanations where necessary

### Part A: Personal information

1. Indicate your gender

Female

Male

2. As agents of the company, are you on:

Accounting/auditing department  Operations Department

3. How long have you been a member of management?

Less than one year  1-3 years  More than 3 years

4. Level of Education

5. Age of the Respondents

18-25  26-30  31-35  36-40

41-45  46-50  51 and above

### Part B: Accelerated Depreciation

6. Does your company have a depreciation policy on assets?

Yes  No



7. If yes, what is the depreciation policy on the assets of the company?

\_\_\_\_\_

8. Were you involved in the choice of the depreciation policy?

\_\_\_\_\_

9. If no in (4) above, how do you account for depreciation of the company assets?

\_\_\_\_\_

10. We follow the policy/ method above in (5) and (7):

Very strictly  Strictly  Moderately

11. If strictly or moderately, in (8) how often does the policy/method change?

Two years period  3-5years  6-8years  9-10 years

12. Give a reason(s) for your answer in (9) above.

(i)

(ii)

13. As a manager, do you justify changes in depreciation policy to shareholders?

Yes  No

### **Part C: Income Smoothing**

14. As an organization, what is the dividend payout policy to shareholders out of profits?

Constant payout policy

Stable dividend policy

Residual dividend policy

Others (Specify)

(i)

(ii)

15. Apart from capitalizing your reserves, what is the company's policy on retained earnings? \_\_\_\_\_

16. How often does the company's dividend payout policy in (12) above change?

Very often

Often

Rarely

17. If often or very often in (13) above, what duration is considered to change the dividend payout policy?

Two years period  3-5years  6-8years  9-10 years

18. Give reason(s) for your change dividend payout policy?

(i)

(ii)

**Part D: Tax Avoidance**

19. What is your company policy on provision for bad debts as a percentage?

\_\_\_\_\_

20. In the last 10 years, how often have you changed the policy in (12) above?

Never  Two years period  3-5years  6-8years

9-10 years

21. Give a reason for (15) above:

(i)

(ii)

22. What is the percentage of earnings capitalized?

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23. In the last 10 years, how often have you changed in (17) above?

Never  Two years period  3-5years  6-8years  9-10 years

24. Give a reason(s) for (18) above

(i)

(ii)

*Thank you for taking your time to respond to the questionnaires.*