THE EFFECT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ACCOUNTING FOR LEASES 16 ON FINANCIAL REPORTING QUALITY OF COMPANIES LISTED IN THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

I hereby agree that this project is original and it has not been used in any other university in the world.

Sign ..... Date 19/11/2021

Janet Chumba (D61/11359/2018)

This analysis has been presented with my approval as the supervisor of the University

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DEDICATION

I dedicate this project to my Family and close friends for their support. I also thank the God for his faithfulness.

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LIST OF ABBREVIATIONS

IAS 17- International Accounting Standard 17

IASB - International Accounting Standards Board

IFRS 16 -the International Financial Reporting Standard (IFRS) 16 Leases

NSE- Nairobi Stock Exchange

FRQ-Financial Reporting Quality

RL-Remaining Life of an Asset

ROA- Return on Assets

ROU- Right of Use

ABSTRACT

The study examines the effect of the adoption of International Financial Reporting Standards Accounting for Leases (IFRS 16) on the quality of financial reporting of Kenyan listed firms. The research considered other variables in determining the effect. Included in the model as control variables are profitability, liquidity, leverage and firm size. The research takes a quantitative approach where quantitative data was collected and analyzed. The response variable, Financial Reporting Quality (FRQ) is measured using the quantitative approach developed by Nijmegen Center for Economics (NICE). FRQ metrics with 33 components make the response variable, whereas company-specific characteristics of leverage, firm size, profitability, liquidity and IFRS 16 adoption make up the predictor variables. A dummy variable measures IFRS 16 adoption is with value 0 before adoption and 1 after adoption era. The researcher derived data used for the study from the yearly issued statements of entities trading at the NSE for the accounting years 2017-2020. Period 2017 & 2018 represent pre-adoption period while year 2019 & 2020 represents the post-adoption period. The researcher analyzed the data via means of descriptive statistics, correlation analysis, analysis of variance, as well as panel regression analysis. Only IFRS 16 adoption was statistically significant in explaining the quality of financial reporting of quoted entities in Kenya. The study results show that, IFRS 16 adoption enhances the quality of firms' financial reports. Scholars, investors, managers, policymakers, and regulators could use these findings to enhance financial reporting.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

International Financial Reporting Standards are principal-based internationally recognized accounting standards issued by International Accounting Standards Board that give entities directions and guidelines for financial reporting. According to Daske et al. (2008), the new IFRS seeks to improve accounting quality and shrink barriers to multinational trading. They ensure the financial statements are consistent, transparent, and comparable all over the world. IFRS 16 Leases, put forth by IASB in January 2016, took over from the former lease regulation International Accounting Standard 17. IFRS Foundation (2019b) states the aim of the standard is to portray lease undertakings faithfully and give a premise for financial statement users to evaluate the value, unpredictability, and timing of cash-flows resulting from leases. The principal reason for the change was to overcome the weaknesses of IAS 17 on the segregation of leases into capital and operating lease and the subsequent accounting treatment of the latter. IASB pointed out that asset and liability recognition for all leases as required by IFRS16 portrays a true financial situation of an entity and a clearer picture of the performance of an entity. This will allow various parties to underscore the financial standing of the particular entity.

Longing for quality in financial reports relates to information asymmetry and agency problems. Information asymmetry comes about because of company management having more access to higher quality information than the owners and debt holders. An agency relationship occurs when the shareholders (principals) invest their

resources in the company and delegate management (agents) control over processes and decisions of the entity. The theory assumes managers to be self-interested and work on their own interests rather than of the shareholders. This misalignment of shareholder and management interests leads to agency problems. The impact of agency problems and the asymmetry of information are detrimental for capital markets and the public (Kao & Wei 2014). Given this, it became imperative to establish a financial reporting system such as IFRS to neutralize the detrimental effects on businesses. Jensen & Meckling (1976) argued that accounting standards address information asymmetry in the relationship between shareholders and management. Adoption of IFRS 16 can mitigate information asymmetry, enhance accounting quality, lessen agency problems and costs, and act as a positive signal to prospective investors. Therefore, agency theory, information signaling theory, and information asymmetry theory are the theories underpinning this study.

In 1982, the International Accounting Standard Committee (IASC), the precursor of IASB, put forth the IAS 17, an accounting system for leases, in the United Kingdom. The system classified leases into capital and operating leases. IAS 17 classified a capital lease as on-balance sheet while it classified an operating lease as off-balance-sheet. The IAS17 model attracted a lot of criticism for the notable lack of transparency about lease obligations. In response to those criticisms, IASB and IASB embarked on a project to better lease reporting. This culminated in issuing IFRS 16 in 2016. IASB issued the standard to ensure high quality and transparency of accounting for leases (Hoogervorst, 2016). The standard was effective from January 1st, 2019. As at the end of financial year 2020, most Kenyan listed companies had implemented the new standard.

1.1.1 International Financial Reporting Standards Accounting for Leases 16

IFRS 16 provides guidelines for when to recognize, measure (by how much amount), present, and disclose lease obligations. The standard will change recognition and reporting of leases by bringing all leases onto the balance sheet except for low-value items and contracts of less than 12 months. Both a lease liability and a right-of-use (ROU) asset are recognized in the books of the lessee at the commencement of the lease. Subsequently, a lessee measures ROU assets on a cost basis less accumulated depreciation. Lease rental expense replaces depreciation and the interest expense in the income statement.

Under IFRS16, all entities account for all leases in the same way. In this way, investors can get a precise image of an entity's lease assets and liabilities and its performance indicators. Investors and other stakeholders will get accurate and transparent financial figures and be able to compare entities that acquire assets via leasing and those that acquire them by buying. Accurate figures can make cross-company comparisons much easier.

Most studies done on the influence of IFRS 16 on entities of ratios and financial statements have employed different methods to obtain values of unrecorded assets and unrecorded lease liabilities. This study uses actual/real data to analyze the effect of IFRS16 implementation on financial reporting quality of Kenyan quoted entities. This use of actual/live data makes this research different from prior studies on the same topic. Most researchers measure the effect of IFRS 16 in terms of the significance of changes to financial statements and performance metrics. The researcher uses a dummy variable with a value of 0 for before IFRS 16 adoption era and 1 for after IFRS 16 adoption era to calculate IFRS 16 adoption, which is the independent variable. IFRS 16

adoption affects the control variables of leverage, liquidity, firm size, and profitability, which are also the determinants of FRQ.

1.1.2 Financial Reporting Quality

The degree to which financial reports give genuine, accurate information concerning an entity's financial position determines the quality of financial reporting, Tang, Chen, and Zhijun (2008). It is the value of the information in the financial reports, including disclosure in the notes. High-quality reporting makes information valuable for making investment decisions that are relevant and faithfully represent the company's position and performance. High-quality financial reports conform to accounting standards and embody both fundamental and enhancing attributes of financial reporting information. Faithful representation and relevance are fundamental qualitative aspects, whereas understandability, comparability, verifiability, and timeliness make up enhancing qualitative aspects. These characteristics facilitate an improvement in evaluating and assessing the usefulness of financial reports.

IASB Conceptual Framework (2018) says financial reporting aims to furnish the users of financial information with useful financial information for decision-making. To make these assessments, users require information about the assets, liabilities, income and expenses of an entity. They likewise need to assess how efficiently management has used the economic resources of an entity. Financial reporting of high enhances the transparency of financial reports, improves analytical capacity, and improves decision-making.

Financial Reporting Quality (FRQ) is the response variable, and the researcher calculated it using 33 conceptually-based measurement scores. These measures are detailed and multidimensional quality testing methods, inclusive of both fundamental

and enhancing qualitative characteristics that are essential in decision-making. Thirteen aspects deal with relevance, seven with faithful representation, six with understandability, six with comparability, and one with timeliness. The model's capability to address both monetary and non-monetary reporting quality characteristics makes it highly recommended. The model is the only one that uses IFRS standards to assess reporting accuracy.

1.1.3 International Financial Reporting Standard 16 (Leases) and Financial Reporting Quality

Recognition, measurement, and classification of balance sheet items, expense, and revenue recognition on the income statement are potential problems that can influence the FRQ. The balance sheet lacks the completeness aspect of financial reporting quality if material amounts of assets and liabilities lack in the balance sheet. IFRS 16 recognition requirement will bring previously unrecognized assets and debts into the statement of monetary position. Rasha (2017) showed that financial leverage and FRQ have a notable positive relationship.

Prior studies on how financial statements and ratios are affected by operating lease capitalization found out that lease capitalization has a notable influence on the financial position, an entity's leverage, its profitability, and its liquidity ratios. For instance, Pardo & Giner (2018) observed that lease capitalization increase leverage (2.31%) and ROE (1.33%). (Xu et al., 2017) observed an improvement in the debt equity ratio (41.87%) and a decline in turnover of assets (9%). Prior research on FRQ focused on the impact of adopting IFRS on FRQ. Thus, research on the effect of IFRS 16 on FRQ is scarce. Byard, (2011); and Chen (2010) argued that IAS/IFRS removes accounting options that managers used to portray a skewed picture of the financial situation of an

entity. Limiting these options would improve the quality of financial reporting. From this, we can deduce that IFRS 16 will improve FRQ. The FRQ in the post-IFRS 16 implementation era is expected to be higher than in the pre-IFRS 16 implementation era.

1.1.4 Nairobi Securities Exchange

Nairobi Securities Exchange (abbreviated NSE) is a dominant exchange platform in East Africa and rated among the leading and most performing stock market in Africa (Olweny 2012). NSE is under the control and jurisdiction of the Capital Markets Authority. Having its base in Nairobi, it is the only exchange we have in Kenya. The British colonialists around the 1920s established it as an unofficial market for whites only. Its official incorporation into a company took place in 1950. Until 1963, Africans and Asians could not take part in and exchange in the market. Since then, the market has grown in leaps and bounds and has a market capitalization of over 2 trillion shillings and a turnover of 236 billion. NSE provides an automated platform for trading in equities and debt instruments. It also supplies market reports daily and list-price of securities to make sure that capital providers always know the value of their investments.

Use of market capitalization, market turnover, or a market index measures the stock market performance (Kithinji & Ngugi, 2009). ICPAK, as the professional accounting regulator in Kenya, embraced IAS for financial reporting in Kenya in the year 1998. All listed firms with no exclusions had to adopt IAS as of the 1st of January 1999. All quoted firms must follow IFRS as it is the successor of IAS. As new reporting standards are being issued by IASB, it is imperative to analyze their impact on listed companies' financial reports.

1.2 Research Problem

IAS17 treats a capital lease as an asset, thus is on the statement of financial position and an operating lease as an expense, thus is off the financial position statement. IASB effect analysis (2016) estimated non-cancelable undiscounted future lease obligations at $2.86 trillion. This value is more than the value of finance leases and shows the issuers` preference for operating leases over finance leases. Some advantages of operating leases over finance leases include off-balance-sheet treatment, tax-deductibility of lease rentals, simpler accounting, more flexibility, and reduced risk of obsolescence. It also improves the debt/equity ratio, current ratio, and ROA. These operating lease advantages create incentives for businesses to have their leasing agreements and terms changed to fit the requirements of an operating lease. According to Imhoff, Lipe, and Wright (1991) management boosts performance and indebtedness measures by evading capitalization of leases. The operating leases are around thirteen times greater than capital leases (Beattie, Goodacre & Thomson, 2000). Because of the huge proportion of off-balance leases, shifting from IAS 17 to IFRS 16 necessitated a study of the impact of the adjustment on issuers' financial results and financial statements.

Globally, leasing is a growing source of asset financing. The worldwide leasing industry has grown by 131% within the past nine years (2011-2020) White Clarke Group - Global Leasing Report 2020. The leasing sector in Kenya varies and comprises different categories of leases, including finance, operating, hire purchase, and asset-based finance leases. Of these, one of the largest in value terms is operating lease finance. Amongst different categories of leases, operating leases are popular

because of the incentives it offers. A study done in 2020 indicated that the total value of leases, together with other asset-based finance products, stood at 46 billion shillings. Estimates from the responses to the information requests were of a magnitude of around 54 billion shillings. The estimated volume of leases shows that leasing is also an important form of financing within the Kenyan economy. A literature review of existing studies shows that the topic is under-researched in Africa. This study, therefore, gives an insight into the effect of IFRS 16 from a different perspective, the Kenyan context.

The large volume of operating leases and its accounting treatment has attracted lots of research before and after issuing IFRS 16. Studies conducted by Bernnet & Bradbury (2003), and Wong & Joshi (2015) aimed to examine the effect of operating lease capitalization in financial statements, ratios, and metrics of companies from industrialized and developed countries. There is limited research on the topic within the African context, a gap which the current study seeks to fill.

Tarus (1997) studied factors that influence the growth of leases in Kenya. Winfred (2014) studied how lease financing affected the financial performance of entities publicly trading at the NSE. Isabwa (2014) researched how the financial performance of sugar manufacturing companies in Kenya is affected by operating lease financing. There are limited studies in Kenya on leases and none on IFRS 16 impact on financial reporting quality. The researcher links the research problem to the impacts of IFRS 16 on the FRQ of Kenyan quoted entities. This study uses the data got from the financial statements reported for the 2017 and 2018 financial years from a sample of 35 companies to capitalize on operating leases. The study will expand knowledge of the subject by examining the issue from a fresh setting/ context. This study answers the

question; what are the impacts of IFRS 16 (leases) on the quality of financial reporting of quoted Kenyan companies?

1.3 Research Objective

The objective of this study is to assess the impact of applying IFRS 16 on the quality of financial reporting of listed companies in Kenya.

1.4 Value of the Study

Understanding how IFRS 16 impacts financial reporting quality of NSE listed entities is beneficial to a variety of stakeholders, including investors, companies, policy makers and researchers. The researcher expects this study to be beneficial in terms of policy, practice and theory. In theory, this study will be an addition to the existing pool of knowledge in IFRS 16 and offer in-depth information critical for future research in terms of the literature review and reference. Current and future researchers will refer to the findings and be better informed on the effects of IFRS 16 on FRQ quality of companies. It also provides useful insights into the effect a single standard can have on the quality of financial reports.

The findings of this study could trigger increased demand for high-quality information. Investors would want any other items that are not visible on the face of financial statements to be disclosed and made more visible. Investors and other stakeholders may require companies to report all data that may not be apparent on the face of the financial statements and that may affect the quality of those statements and financial results. This will provide a more transparent image of the company, resulting in better decision-making concerning investment and financing.

The findings of this analysis illustrate the effects on the FRQ of the sampled quoted entities of IFRS 16 adoption. The management of the companies listed could utilize the study's findings to attain or monitor the optimal level of the FRQ indicators. The management of the listed companies could use the study`s outcome to formulate policies that facilitate better and quality reporting of their companies, thus making them more desirable to potential and existing investors. The findings of the study will also give incentive to unlisted entities that have not yet adopted IFRS in their financial reporting to consider implementing IFRS.

The study gives businesses the chance to reconsider if leasing assets is the best way to finance their operations. I expect some companies might need to make some changes to decisions related to operating leases. For example, current lessees might prefer to raise debt and purchase rather than lease an asset, especially of leased small-ticket assets, such as cars, copiers, and coffee machines. IFRS 16 would treat both leases the same way as debt in financial statements; hence, lessees might have stronger incentives to own. They might attempt to redefine the conditions and terms of current and future leasing contracts to fit the short-term classification.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This segment reviews and summarizes the findings of the research that has been conducted in the field of study. It shows where there is a need for my research and builds a foundation for the research method.

2.2 Theoretical Review

2.2.1 Agency Theory

The agency relationship, according to Jensen and Meckling (1976) is a contract in which the principal (s) contract the agent to carry out specific service on their behalf; the contract involving assigning the decision-making mandate to the agent. Management of the contract is thus the responsibility of the agent, while the principal is the shareholder. Shareholders invest their resources in the company but have no or little control over the operations and decisions of the company. A problem of determining managerial accountability arises because the theory assumes managers act on their own interests. The agents are inclined to follow self-interested goals that depart from, and even conflict with the principal's goals.

Asymmetry in information is one of the crucial factors giving rise to agency problems as managers have more information access more than the shareholders (Brown and Hillegeist, 2007). High-quality financial reporting reduces information imbalance between the agent and the principal and by enhancing the reliability and accuracy of information regarding lease obligations. The agency theory sees the company as an organizational form working to minimize agency problems by

adopting IFRS (Jensen & Meckling, 1976). Therefore, the adoption of IFRS 16 will reduce agency conflicts and costs, as it will improve the quality of financial information disseminated to the various stakeholders.

Critics of this theory argue that it is a generalization that applies to all managers when only a few (exceptions) serve their interests. They argued that most managers are responsible stewards of the resources they control. The theory is biased as it stresses on the monetary factors and excluding other factors, such as corporate governance issues, political factors, and parts played by other stakeholders. Monitoring and supervisory measures proposed by the theory are costly and may be ineffective in protecting shareholders` interests only may hinder attainment of strategic goals (Segrestin & Hatchuel, 2011)

2.2.2 Information Signaling Theory

Spence (2002) explains that the Information Signaling Theory concerns minimizing information asymmetry between the principal and the agent. The existence of asymmetry of information is a basis for successful entities to use financial information to convey signals to the market players. Spence (1974) therefore expounds that companies signal investors with the information to minimize information asymmetry between the investors and their firms. Furnishing investors with transparent financial reports offers a good sign to investors that their resources are being managed efficiently.

According to Zhang & Wiersema 2009, entities signal the invisible qualities of their entities to prospective investors through the visible quality of their financial reports and statements. The researcher expects IFRS 16 adoption to enhance FRQ. IFRS 16 adoption, therefore, is a good sign to the shareholders because the high quality of

information disclosed under the standard can improve investors` income, attract more investments and improve the company's image and value.

2.2.3 Information Asymmetry Theory

Asymmetry in information takes place where one party (the manager/agent) possesses less information than the other party (shareholders/principal). It results from the agent having control over the daily business processes and control over decision-making. Providing information regarding a firm's undiscounted obligations for the leases is an off-balance sheet solely in the notes on the financial reports is inadequate disclosure for the investors. Investors will have to apply different techniques to incorporate off-balance sheet leases into the balance sheet. Others make no adjustments at all. This results in different investors having differing estimates of unrecorded assets and liabilities for an identical set of financial statements. However, the new standard requires lessees to disclose more information regarding off-balance-lease obligations through its financial statements. This helps reduce information asymmetry costs and related problems.

From the theoretical review, we can observe that the adoption of IFRS 16 will reduce agency problems, reduce information asymmetry, and send a positive signaling effect to all investors. All these will be an advantage to the firm because it can help enhance the firm's corporate image and improve relations with various stakeholders.

2.3 Determinants of Financial Reporting Quality

Operationalization of qualitative characteristics is a determining factor in QFR. Other factors include the firms' leverage, scale, liquidity, and profitability.

2.3.1 Operationalization of Qualitative Characteristics

In QFR, the operationalization of qualitative attributes is a key determinant. Some of the basic elements of financial reporting that will be included in the model include relevance, faithful representation, comparability, understandability, and timeliness. When information in annual reports has both predictive and confirmatory values, it is relevant. This is accomplished when financial reporting information can affirm or change past or current expectations derived from previous assessments. (IASB, 2018). The degree to which information in annual reports accurately reflects the economic condition it seeks to depict is known as faithful representation. It must be comprehensive, impartial, and clear of major flaws (IASB, 2018).

Understandability is achieved when information provided in financial statements can facilitate easier and better understanding. To realize this, it must be clear and precise. It is measured by considering items that values openness and clarity of the information contained in yearly reports (IASB, 2018). Comparability is defined as the consistency of which accounting principles and practices are followed from period to period. When accounting procedures and policies are applied uniformly over each financial cycle, users can draw insightful conclusions about an entity's patterns and performance over time. Timeliness entails having access to information as soon as possible. Annual report timeliness has an effect on QFR and is determined by the amount of time it takes the auditor to sign the auditor's report after the year ends.

2.3.2 Leverage

Leverage measures debt proportion of an entity’s capital structure. The debt ratio (TL/TA) measures the leverage of a firm Monday and Nancy, (2016). Entities with higher leverage are under firm scrutiny by debt providers, and hence, they are prone

to disclose more and provide quality financial reports to assure creditors of their ability to repay their interests plus the principal. Adelopo (2010; Uyar (2013) and Takhtaei (2014) showed a constructive relation between leverage and FRQ whereas Connors and Gao (2011), Monday and Nancy (2016) showed a negative association. These differing outcomes give sincere inducement for further assessment of this association. The researcher expects the association between leverage and FRQ to be positive.

2.3.3 Profitability

A profitable entity discloses more detailed information to show the consistency and reliability of its recorded profits and improve its image and keep away from the underestimation of its equity. Alsaeed (2006) claims that a profit-making entity feels proud of its accomplishments and would provide quality reports and disclose more to the general populace to foster a good perception of its performance. Monday and Nancy (2016) established an adverse association between profitability and FRQ while Fathi (2013) and Al-Asiry (2017) found a noteworthy constructive association between profitability and FRQ. The researcher, therefore, expects that profitability will have a positive relationship with FRQ. ROA (PAT/TA) is a good indicator of profitability, thus the researcher takes it as the measure of profitability.

2.3.4 Firm Size

Logarithms of total assets measure Bank Size (Siz) Monday and Nancy (2016). Larger firms have the advantages of possessing great financial strength, a highly skilled workforce, and superior information systems that give them the capability to supply more information at low costs. Larger firms are also more stakeholder-orientated and more accountable; hence they are likely to disclose more. Monday and

Nancy (2016) found a notable constructive association between the size of the firm and FRQ, whereas Takhtaei and Mousavi (2012) showed a negative association. The researcher expects the correlation between the firm size and FRQ to be positive.

2.3.5 Liquidity

Liquidity is the ability of an entity to fulfill its ongoing commitments as they accrue. Liquidity which is computed as the current assets divided by current liabilities shows an entity's going concern. A firm with sound financial performance indicators such as liquidity has more motivation to provide information of higher quality. I expect the association between liquidity and FRQ to be positive.

2.4 Empirical Studies

Imhoff et al. (1991) studied McDonald's by capitalizing operating leases, then assessing the effects on the assets and liabilities of the entity. He employed the method of constructive lease capitalization that he himself developed for analysis. The study was significant because prior research on leases did not apply such a method. Subsequently, some researchers adjusted the method to suit the objectives of their studies. He focused his study on the balance sheet effect of capitalization. The results have shown that ROA decreases by 9%, Liabilities/Equity ratio increases by 30% and total assets shall increase by 10% after capitalization.

While assessing the effects of capitalization of operating lease on entities quoted on the New Zealand Stock Exchange, Bennett & Bradbury (2003) used financial statements and constructive lease capitalization method from a sample of 38 companies to approximate the unrecorded lease liabilities and assets. The results showed an increase of 10.6% in the TL/TA ratio, a decrease of 8.7% in ROA ratio, an

increase of 22.9% liabilities, and a decrease of 14.2% current ratio. To analyze the results, the author used a Spearman correlation to authenticate the capitalization method. He also carried out a sensitivity analysis for the residual lease period. An assumption of 81% assets to liability ratio for the entire sample is a limitation of this study.

Morales-Diaz and Zamora-Ramirez (2018) assessed the effect of IFRS 16 on company financials from a sample of 646 quoted firms from varied sectors in Europe. Unlike previous studies, they did not discount FMLP. Instead, they estimated future lease payments using the mean contract life reported by some companies and some they got from the companies themselves. They also adjusted the discount rate used for each firm based on factors that include the firm's rating. The results showed an increase in total assets by 9.96%, Total liabilities by 21.4%, leverage by 9.28%, and ROA by 3.07%. They concluded IFRS16 implementation has a notably affected the balance sheet, gearing, and solvency of quoted firms. They analyzed the significance of the deviations by use of a t-test.

While assessing the effect of lease capitalization (Pardo & Giner (2018) used a total of twenty non-financial entities in the IBEX 35 and noted an increase in assets (3.5%), liabilities (7%), Leverage (2.32%), and ROE (1.33%). There was a decrease in non-current asset turnover of 96.56%), equity (2/3%), and ROA (2.15%). They did the statistical analysis using the Wilcoxon test and the discount rate's sensitivity analysis. Modifications to the constructive capitalization method include using the use of company-specific interest rates, as the discount rate for discounting, decreasing factor to get FMLP values between years 1 and 5, and a 50% ratio presumption for the proportion of RL/TL. The findings showed a notable impact on the financial ratios of

entities. One limitation of the study is the use of a small sample size of 20 firms, which is too small for making sectoral analysis.

Rasha (2017) researched the determinants affecting the quality of financial reporting. He used a sample of twenty-two banks from Lebanon for the year 2012 to 2015. To measure the dependent variable, he used the FRQ index with 40 items. Bank-distinct aspects such as leverage, ownership structure, profitability made up the independent variables. The findings showed financial leverage had an important constructive association with FRQ. Bank size and profitability were not statistically significant. He concluded that a big board size higher leverage and higher ownership by the shareholders could improve the FRQ of the annual reports in the banking sector.

Tarus (1997) investigated factors that influence the growth of leases in Kenya. Using a descriptive research design, he got primary data using questionnaires and established that cash flow conservation and protection against obsolescence are the major reasons any firms use lease financing.

Winfred (2014) researched on how the financial performance of Kenyan quoted firms lease was affected by lease financing. She took ROA as the measure of financial performance (a dependent variable); company liquidity, leverage, amount of operating lease, and finance lease, and size as the independent variables. The findings showed the size of the firm and lease financing has negative effects on ROA, while leverage and liquidity affect ROA. At a 5% level of confidence, both the positive and negative effects lacked statistical significance. She concluded that the performance of entities quoted at the NSE was not affected by lease financing.

Isabwa (2014) studied the impact operating lease financing had on the financial performance of government-owned sugar manufacturing entities in Kenya. The

population of the study is four state-owned sugar firms. He collected data from the yearly reports of the entities for the periods between 2010 and 2014. His fshowed ROA is negatively affected by operating lease finance (r = -.475, p = 0.008).

Mutai (2014) studied the impact of IFRS on FRQ in companies quoted at the NSE. He used both qualitative and quantitative data from a sample of 31. He measured FRQ using the relevant qualitative characteristics as per the IASB conceptual framework. Descriptive statistics, regression analysis, and tests of significance were used for analysis. The findings showed a direct relationship tween IFRS adoption and FRQ.

Obiero (2016) researched the outcome of lease funding on the economic performance of Kenyan quoted companies. He used a total of 33 entities from a population of 65. ROA represented the dependent variable, whereas lease financing, liquidity, firm size, and gearing as the predictor variables. Data was hand-picked from yearly reports of the firms for years 2011-2015. To analyze data, he used SPSS statistics. Regression analysis results showed that leasing had a notable impact on a company's asset return measured using ROA.

2.5 Conceptual Framework

A conceptual framework is a visual framework that depicts the interconnections between variables. Here, IFRS 16 adoption is the independent variable which has a value of zero (0) in the period prior to the adoption and one (1) in the periods of adoption and FRQ is the response variable. Firm size, leverage, liquidity and profitability are the controlling variables. The figure depicts the relationship between Kenyan quoted companies' adoption of IFRS 16 and their QFR. The adoption of IFRS

16, as well as the size, profitability, liquidity, and leverage of listed companies, all have an effect on the QFR variable.

Figure 2.1 Conceptual Model 1

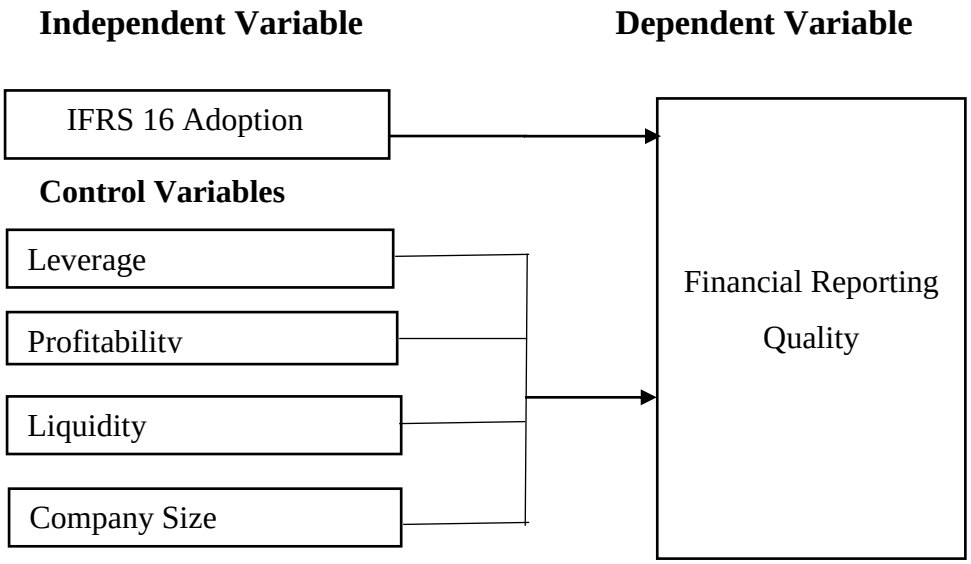

Fig. 1: Conceptual Framework Model

Source: Author, (2021).

2.6 Summary of Literature Review and Research Gaps

Different authors have focused on different aspects of leasing and FRQ, as seen in the literature review. Morales-Diaz & Zamora-Ramirez (2018), Pardo &Giner (2018), and Jared (2019) concluded that IFRS 16 impacts the financial statements, ratios, and metrics of companies. Rasha (2017) showed that ownership structure, board size, and financial leverage had a notable constructive relation with FRQ.

From the literature review, the authors have done all the studies on IFRS 16 in developed countries. There are very few studies done on IFRS 16 in developing countries like Kenya. That this study is done post-IFRS 16 implementation period implies that the researcher will be able to use actual values of ROU assets and lease liabilities to evaluate the effect of the new standard unlike in previous studies in

which different authors used estimated figures. This presents knowledge, contextual and methodological void that this study aspires to fill.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This part discusses the research method that will respond to the research question and objective. The section explains the study design, the sample population used, and the method of data collection, diagnostic tests and methods of analyzing data.

3.2 Research Design

This research purposes to assess the impact of IFRS 16 implementation on the quality of financial reporting of listed entities in Kenya. Data is collected manually from the yearly reports of listed companies. This research takes a quantitative approach covering four years 2017-2020. Descriptive statistics, correlation analysis, panel regression analysis and ANOVA is used for analysis.

3.3 Population

The sample population for the research includes all 62 NSE quoted Kenyan companies. The researcher used consolidated figures for group companies. As per the end of the year 2020, most companies had adopted the new standard. The researcher analyzed 42 listed companies that had issued their 2020 annual report and had adopted IFRS 16 in their financial statements for the study.

3.4 Data Collection

The researcher used audited financial information, statements, and reports for the financial years ended 2017, 2018, 2019 and 2020 for this study. Data to be drawn out by the researcher include ROA, debt ratio, total liabilities, current ratio, total current assets, total assets, and total current liabilities and net profit for each of the companies This study involves manually getting mixed data to confirm the FRQ and financial reporting power. This help to determine the financial data in the companies selected.

3.5 Data Analysis

3.5.1 Descriptive Statistics

The study uses the median, mean, square root of variance (standard deviation), maximum, and minimum value to confirm the data sets.

3.5.2 Predictive Analysis

To determine variable correlations, the researcher will use a Pearson Correlation Coefficient. The researcher will conduct a regression analysis to assess the influence of IFRS 16 adoption on the FRQ of NSE quoted companies. The linear regression equation is as follows;

FRQ = βo + β1IRS16+β2 Size + β3 Lev + β4 Prof+ β5 Liq +ϵi.

Where:

FRQ = Quality scores of both the fundamental and enhancing qualitative attributes **(R FR U C & T)** IFRS16=dummy variable representing IFRS 16 adoption (Dummy:1=post-adoption era, 0=pre-adoption era); Lev = Leverage; Liq = Liquidity; Size = Firm Size; Prof = Profitability, and **ϵi** the error term. **β**0, **β**1, **β**2, **β**3, **β4 and β5** are parameter estimates corresponding to the explanatory variables.

3.6 Diagnostic Tests

3.6.1 Normality Tests

To establish if data follow a normal distribution, normality tests are used. Tests of normality that the researcher will use for this study include Lilliefors, Shapiro-Wilk, and Jacque-Bera tests of normality.

3.6.2 Heteroscedasticity

It refers to data with unequal scatter or variability across a set of predictor variables. It occurs because of the omission of variables or because of the presence of outliers. A White test or a scatterplot are tests that test the presence or absence of heteroscedasticity.

3.6.3 Multi-collinearity

A strong association/correlation between independent variables in a regression model gives rise to multi-collinearity. Strong correlations between variables impair their independence. Multi-collinearity undermines the statistical significance of an independent variable. VIF exceeding 10 implies high levels of multi-collinearity. In the event it exists, removing the variable and replace it with a one with low multi-collinearity levels can reduce it.

3.6.4 Haussmann Test

As a result of using panel data, two models; the fixed as well as the random values were used in the analysis. Haussmann's test aids in determining which of the two panel regression models is the most efficient and suitable to facilitate the statistical significance. The model was developed by Haussmann (1978), and it is used to select the most efficient model to utilize in the regression.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

The study aimed to evaluate how IFRS 16 influences the financial reporting quality of quoted entities in Kenya. The researcher sourced the research data from yearly reports and financial statements of quoted Kenyan companies. Data drawn out by the researcher include ROA, debt ratio, total liabilities, current ratio, total current assets, total assets, and total current liabilities and net profit for each of the companies for the years 2017-2020. The researcher scored items of the qualitative characteristics of financial information to measure FRQ using the score developed by Nijmegen Centre for Economics (NiCE). 42 companies were used for the study, which represents 67.7% of the total population.

4.2 Diagnostic Tests/ Robustness Test

The researcher carried out diagnostic tests to check the fitness of the model and its element, whether the result provided is reliable. This section contains normality tests, multi-collinearity test, heteroscedasticity test, and the Durbin-Watson test for autocorrelation to determine if the data set was well modeled.

4.2.1 Tests of Normality

They are tests applied in determining if data follows a normal distribution. Normality of data is a fundamental assumption in statistical procedures and tests, such as correlation, regression, and assessment of variance. The research tested normality using the Kolmogorov-Smirnov test and the Shapiro-Wilk Test. If it's less than 0.05,

the data is not distributed normally. Table 4.1 shows the outcomes of the normality test.

Table 4.1 Normality Test Results 1

	Lillefors Test	Sig.	Shapiro Wilk Test	Sig.	Jarque-Bera Test	Sig.
FRQ	0.14806	<0.0001	0.94905	<0.0001	18.3951	0.0001
Prof	0.19988	<0.0001	0.74811	<0.0001	2165.94	<0.0001
Liq	0.25296	<0.0001	0.62574	<0.0001	928.906	<0.0001
Lev	0.15329	<0.0001	0.93607	<0.0001	1.9143	0.3840
Siz	0.07160	0.03	0.87588	<0.0001	759.578	<0.0001
IFRS 16	0.38055	<0.0001	0.62764	<0.0001	28.0674	<0.0001

From table 4.1 above, Leverage has a p-value of over 0.05, while the rest of the variables have a p-value of < 0.05. It implies that leverage is the only variable that follows a normal dispersion while the rest depart from the normal. Xu et al. (2017) and Osyanikov (2019) found financial ratios and metrics, including current ratio, ROA, debt ratio, and total assets, to not follow a normal dispersion. The researcher uses log transformation for total assets to reduce data skewness.

4.2.2 Heteroscedasticity

It occurs because of variable omission or outlier presence. A White test and an F test are tests that test the existence or non-existence of Heteroscedasticity. The test has a

p-value of 0.0045, which implies heteroscedasticity presence. Because of the presence of heteroscedasticity, robust standard errors were employed in the final regression to rectify the bias.

Table 4.2 White Test Results 1

Chi-Square	Observations	Sig.
38.965177	168	0.0045

4.2.3 Multi-collinearity Test

A strong association/correlation between input variants in a multivariate analysis model gives rise to multi-collinearity. Strong associations between variables impair their independence. Multi-collinearity undermines the statistical importance of a predictor variable. The Variance Inflation Factor (VIF) assesses excessive correlation among variables, which thus produce evidence of the robustness of the study. VIF shows how the variation of input variables is inflated by the occurrence of multi-collinearity. As a benchmark for diagnosing multi-collinearity, if the VIF of variables is above 10 or the Tolerance Value (TV) is 0.10, it shows a strong existence of multi-collinearity.

Table 4.3 Multicolleniarity Test 1

	Prof	Liq	Lev	Siz	IFRS 16
Tolerance	0.769	0.620	0.472	0.680	0.983
VIF	1.300	1.612	2.120	1.471	1.017

The above table reveals the non-existence of multi-collinearity among the variants as the CR, ROA, Debt ratio, and firm size all have VIF that are < 10 and Tolerance values that are above 0.1. Based on this, the model is robust for the study, as there is a lack of evidence of multi-collinearity.

4.2.4 Haussmann Test

Both fixed and random effects test was done and a Haussmann test runs to facilitate the choice of the most efficient model. The null hypothesis states that the random effects model is more effective. The results of the test showed a p-value of < 0.05, hence the null hypothesis is rejected in preference for the fixed effects model. In applied econometrics, as a rule of thumb, one should use fixed effect panel regression when they have large N, and small T. In this research, the number of companies (N=42) is greater than the time period (T=4), therefore, the fixed effect can be used as is justified by the Haussmann test.

Table 4.4 Haussmann Test 1

Hausman test statistic:
H = 50.4837 with p-value = prob(chi-square(5) > 50.4837) = 0.0000

4.3 Data Analysis

4.3.1 Descriptive Statistics

The study uses the median, mean, lowest, and highest values and the standard deviation of the entire variable set. This section gives an insight into the properties of the group of data employed.

Table 4.5 Descriptive Statistics 1

	FRQ	Prof	Liq	Lev	Siz	IFRS 16
N	168	168	168	168	168	168
Mean	3.4385	0.0287	1.7031	0.6068	7.5045	0.4226
Median	3.5071	0.0224	0.9972	0.6772	7.5772	0.0000
Std. Deviation	0.3426	0.1055	2.2255	0.2817	1.0130	0.4955
Minimum	2.3966	-0.7383	0.0100	0.0476	0.8099	0.0000
Maximum	4.1954	0.3631	14.1990	1.4264	9.0065	1.0000

Table 4.4 shows the nature and properties of data used in the research and it reveals that FRQ has an average of 3.4385, a median of 3.5071 and a square root of variance of 0.34255, a minimum of 2.3966 and a maximum of 4.1954. The square root of variance reveals that FRQ data are not far spread across the mean, implying that the FRQs of quoted entities in Kenya have a minor variation from one company to the other. Profitability has an average of 0.02828 and a square root of variance of 0.10546. We can deduce from the value of the standard deviation that the ROA clusters closely around the mean of the data under analysis. The lowest value is -

0.7383 and 0.36311 as the highest value thus, some firms have very low current ratios while others have high current ratios.

Liquidity ratio has an average of 1.7031, square root of variance as 2.2255 with the 0.01 as the lowest value and 14.199 as the maximum value. Also, the standard deviation reflects that ROA values are spread out widely around the mean and that some firms have very low liquidity while others have very high liquidity. Leverage ratio has an average of 0.60684, a square root of variance of 0.28168, lowest value of 0.04761, and highest value of 1.4264.

4.3.2 Predictive Analysis

Correlation Analysis

The matrix of correlation aims to display the linear association between predictor and response variables and summarize the essence of the correlation between the predictor variables and the FRQ.

Table 4.6 Pearson Correlation Coefficients 1

Correlation matrix (Pearson):						
Variables	FRQ	Prof	Liq	Lev	Siz	IFRS16
FRQ	**1**	0.067	-0.656	0.342	0.483	0.076

From table 4.6, firm size is the most influential determinant of the FRQ, expressed in the positive and important correlation of 0.483 in the table. The relationship shows that as an organization's size grows, the FRQ also shifts in the same way. The outcome shows that liquidity has an adverse influence on FRQ with a correlation

coefficient of -0.656. Profitability, leverage and IFRS 16 adoption all have a positive influence on FRQ.

Regression Analysis

Table 4.7 Panel Regression Results 1

	Coefficient	***Std. Error***	***t-ratio***	***p-value***	
const	3.43675	0.0224259	153.2	<0.0001	***
ROA	−0.000968	0.0391680	−0.02473	0.9804	
Liq	−0.006171	0.00674148	−0.9154	0.3653	
Lev	0.0364051	0.0335516	1.085	0.2842	
Siz	−0.003163	0.0046205	−0.6846	0.4974	
IFRS16	0.0329137	0.00213694	15.40	<0.0001	***
Mean dependent var	3.438479		S.D. dependent var	0.342546	
Sum squared residual	1.530532		S.E. of regression	0.11246	
rho	−0.997821		Durbin-Watson	2.99667	

The panel regression result revealed a coefficient value of −0.000968 and a p- value of 0.9804 for the profitability metric. It shows that for every 1% increase in the profitability metric, FRQ decreases by 0.0009. The coefficient for liquidity showed a negative and insignificant relationship between FRQ and liquidity. It shows a

coefficient of −0.006171 and p-value of 0.3653. The coefficient for leverage reveals an insignificant positive impact on FRQ since the coefficient is 0.0363874 and p-value is 0.2845, which is insignificant at 5%. Firm size coefficient (−0.003161) reveals an insignificant negative impact on FRQ and p-value is 0.4978, which is insignificant at 5%. The coefficient of IFRS 16 adoption is 0.0329141 at a P-value of <0.0001. The outcome shows that IFRS 16 adoption has a substantial effect on FRQ.

4.4 Tests of Significance

They draw inferences regarding a population from a sample. The researcher will use ANOVA to test the strength of interrelationships between variables. From the ANOVA table below, 55.13% of the variation in FRQ depends on profitability, liquidity, leverage, firm size and IFRS 16 adoption while holding other variables constant. Other determinants not incorporated into the model explain for the remaining 44.87%.

Table 4.8 ANOVA Results 1

		Sum of squares	df	Mean square
Regression	5	10.8034	5	2.16068
Residual	41	8.79195	41	0.214438
Total	167	19.5954	167	0.117337

R^2 = 10.8034 / 19.5954 = 0.551325

Table 4.8 shows an F-significance value of 10.0894 and a p-value of 0.000 thus the results depict the model is fit and reliable. This means that at a 5% level of

significance, the model is statistically significant in predicting the relationship between IFRS 16 adoption and FRQ.

4.5 Analysis of Findings

4.5.1 Financial Reporting Quality and Profitability

The coefficient for profitability showed that there is a negligible and insignificant association between FRQ and profitability. Previous studies have shown mixed results on the association of profitability with FRQ. Studies conducted Takhtaei et al. (2014) and Al-Asiry (2017) showed a notable constructive relation while those conducted by Monday and Nancy (2016) and Ebrahimabadi and Asadi (2016) showed an adverse relation. The findings of the study reveals that profitable is not a material or important factor in explaining the FRQ of quoted Kenyan entities. Profitable and non-profitable companies provide similar financial reports in terms of quality.

4.5.2 Financial Reporting Quality and Leverage

The coefficient for leverage reveals an insignificant positive impact on FRQ. The correlation matrix shows that leverage has constructive association with FRQ. Studies performed by Elshandidy 2011; Takhtaei 2014, have shown that financial grip has a positive correlation with FRQ. Fathi (2013) and AL-Asiry (2017) found leverage to be not statistically significant in explaining FRQ, and this is in agreement with the results of this study.

These findings suggest that entities with huge obligations reveal sufficient data to reassure their creditors. They are also subjected to more agency problems hence the need to provide quality reports to reduce agency costs and conflicts. Businesses with

more debt, according to Fathi, have more data to provide access to capital shares and to convince shareholders of the company's notion of going concern. These studies have provided clear evidence that leverage does affect FRQ positively though not statistically significant.

4.5.3 Financial Reporting Quality and Firm Size

The firm size coefficient reveals an insignificant negative effect on FRQ. Previous studies on the impact of firm size on FRQ has yielded varied results. Ebrahimabadi and Asadi (2016) and Monday and Nancy (2016), for example, discovered a noteworthy constructive association between business size and FRQ. They argued that large corporations are more likely to report more high-quality data because they are scrutinized more and have more technical and financial muscle to do so as compared to smaller firms.

Takhtaei and Mousavi (2012) and Al-Asiry (2017) found a negative insignificant association between firm size and FRQ. This is in agreement with the results of this study. This finding reveals that companies with smaller sizes provide quality financial reports in the same way their bigger counterparts do. It indicates that smaller companies have exhibited their determination to produce high-quality reports in order to get competitive advantages and public recognition.

4.5.4 Financial Reporting Quality and Liquidity

The results revealed that liquidity does not affect FRQ significantly. Liquidity also showed a negative association with FRQ. This implies that entities with high liquidity disclose less information that translates into lower quality of their financial reports. A

firm with sound financial performance indicators, such as a balanced liquidity, has more motivation to provide information of higher quality. The high value resulting from the liquidity ratio may be a sign the company is overly focused on liquidity, which can be detrimental to the effective use of capital and business expansion. The negative association of liquidity with FRQ justify this argument.

4.5.5 Financial Reporting Quality and IFRS 16 Adoption

The coefficient of IFRS 16 is 0.03163 at a P-value of <0.0001. The findings show that IFRS 16 adoption has a considerable effect on FRQ. This means that for every one percent rise in the variable, the FRQ increases by 3.29 percent. This implies that a single standard on its own, can have the ability to significantly affect the quality of financial reporting of issuers. The above findings conform to research findings by Okuta (2011) who noted that adoption of IFRS is significant in promoting FRQ.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

Chapter five entails the study summary, conclusions, limitations and suggestions from the study analysis. This chapter also suggests further researches on IFRS 16 adoption and financial reporting quality of companies.

5.2. Summary of the Results

The main purpose of this inquiry was to evaluate and assess the impact of the newly adopted lease accounting standard IFRS 16 on the financial reporting quality of quoted Kenyan companies. Quantitative data for analysis was obtained manually from the yearly reports of 42 companies out of a target population of 62 companies. This represents 67% of the population, which is sufficient for the researcher to make conclusions regarding the connection among the variables of the study. The research heavily relied on non-primary information from the internet sources, Nairobi security exchange data and reports as well as the websites of the listed companies. Data collected pertains to the profitability, leverage and liquidity metrics for a period covering four years from 2017-2020. FRQ was obtained by scoring both fundamental

and enhancing qualitative characteristics using a scoring index developed by Nijmegen Center for Economics (NiCE). 33 items are used to measure FRQ. The control variables are profitability ratio, liquidity values as well as leverage figures and the company size. Descriptive and inferential analysis was the key tools used for analysis.

The study shows that firm size, leverage, profitability and liquidity, with a 95% confidence level, do not have a statistically significant bearing on the FRQ of the firms sampled. The IFRS 16 adoption on the hand showed a significant relation with FRQ. All the variables under study, except for IFRS 16 adoption and leverage, exhibited a negative association with FRQ. The value of R^2 from the regression analysis showed that 55.13% of the change in FRQ was attributable to the variables under study. Other variables not accounted for in the study explained the remaining 44.87%.

5.3 Conclusion

Introducing IFRS 16 is one of the most challenging changes in the accounting framework worldwide. Over the decades, the content of IFRS 16 has been a topic of debate and dispute among academics, in particular the treatment of operating leases as off-balance sheet. Adoption of IFRS 16 creates the need to examine whether IFRS 16 has any effect on FRQ of entities. This is quite a new aspect of accounting, especially with Kenya. This study has empirically examined the impact of IFRS 16 adoption on the financial reporting quality of quoted entities in Kenya.

The researcher can draw many conclusions from the findings of the study. The insignificant weak negative impact that firm size showed on FRQ implies that

companies listed at the NSE whether small or big provide quality financial reports. It means that small businesses have demonstrated their willingness to deliver high-quality reports in order to gain competitive advantages and public attention. The profitability metric also showed an insignificant and weak negative relationship with FRQ, implying that profitability of a firm does not influence FRQ.

Leverage ratio showed a positive though not substantial impact on FRQ. The conclusion is that the FRQ increases as leverage increases. Leverage is the level of a firm's indebtedness. High leverage ratios show high indebtedness and the inability of the firm to repay its capital providers. To satisfy their creditors, highly geared firms are enforced to disclose more. Highly-leveraged firms have a tendency to reduce agency costs they are subjected to by providing high quality financial reports.

Liquidity ratio showed a negative and non-substantial impact on FRQ. A high liquidity ratio is an indicator of excess capital being held in cash, bank or in liquid assets instead of it being used to grow and expand the company. Firms with high liquidity therefore prefer to disclose less information to the public as this could turn away potential investors as well as attract more scrutiny from debt providers.

Drawing from the research findings, there is evidence that the implementation of IFRS 16 has improved the FRQ. According IASB, IFRS 16 was issued to improve the quality of financial reporting and the study results reveal that that objective has been met.

The adjusted R2 of 55.13 percent indicates that the variables under investigation account for 55.13 percent of the change in FRQ. The researcher concludes that even

though the variables under study were highly related to FRQ, other factors which account for the remaining 44.87% affect financial reporting quality as well.

5.4 Limitations of the Study

First, the researcher centered this study on small samples for future studies, the use of larger samples, and lengthier time frames could give greater insights into the external validity and reliability of the results. Second, the researcher explored only basic FRQ determinants of companies listed in Kenya in this study; future studies may be carried out on listed entities in other East African countries independently or collectively. Finally, this analysis was based upon five FRQ determinants; there are still many factors affecting the FRQ; besides the determinants tested in this study, future studies will examine more determinants. Besides describing only 55.13% percent of variance in FRQ in this analysis, other researchers will define and describe the direction to include other variables.

5.5 Recommendations for Policy and Practice

In light of the study's findings, the researcher suggests the following recommendations. Research findings from section four provides evidence that IFRS 16 implementation has improved FRQ. The study therefore, recommends a wider application of IFRS to include other organizations operating in the country, which are currently not mandatorily required to use IFRS for their financial reporting. Large organizations and other entities not currently reporting under IFRS could be required to adopt IFRS in their reporting to achieve consistency in financial reporting in the economy.

The study findings reveal that IFRS 16 adoption improves the transparency and quality of financial reports, as envisioned by IASB. By extension, it implies that bringing off-balance sheet items onto the face of the financial statements improves FRQ. The demand for high-quality information will increase with IFRS 16 introduction. Investors and other stakeholders may require companies to report all data that may not be apparent on the face of the financial values and that may affect those statements and financial results. Firms need to be ready and willing to meet this increasing demand.

The tests found that the liquidity variable negatively affects FRQ. It means that companies with high liquidity ratios may have financial reports of lower quality. The researcher recommends that auditors, boards of directors, analysts, regulators, and shareholders consider investigating the financial information provided by companies with high liquidity ratios. Since liquidity hurts the quality of business financial reporting, the study strongly advises that company management devise and plan strategies and policies that not only optimize liquidity but also enhance FRQ.

Companies will continue to require assets in order to generate revenue and operate their firms, and they have two alternatives for obtaining them: purchase or lease. The overall asset demand will not change as a consequence of the introduction of new standards of accounting. The adoption of IFRS 16 will have no effect on total asset demand, but it may have an impact on the lease vs. buy decision. According to the findings of the study, the main predictor variable, IFRS 16 adoption, has a constructive significant effect on FRQ. The researcher recommends that companies not change policies relating to the use of leases. They can continue to either buy or

lease to obtain assets after the adoption of IFRS 16 in the light of the considerable benefits associated with either leasing or buying.

5.6 Areas for Further Research

Future researchers can adopt studies that focus on how IFRS 16 implementation affects borrowing and lending costs of different companies. This would increase the lenders knowledge and be able to understand credit risk and how to regulate their lending plans. In most cases, different companies have different lending plans and borrowing procedures.

Other potential areas for research under IFRS 16 include the effects of the standard on debt covenants, on the demand for leases, and on the regulatory capital requirements of lessees that are financial institutions. The variables under study explained only 54% of the variance in FRQ. Other researchers in the future can explore the other variables not included in the study that can also affect FRQ.

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APPENDICES

Appendix 1- Listed Companies in Kenya

	Company Name
1	ABSA Bank Kenya
2	ABSA Limited
3	Athi River Mining
4	B.O.C
5	Bamburi Cement
6	Britam Holdings
7	British American Tobacco
8	Car & General (K)
9	Carbacid Investments
10	Centum Investments
11	CIC Group
12	Crown Paints Kenya
13	Deacons (East Africa)
14	DTB Kenya
15	Eaagads Ltd
16	E.A Cables
17	E.A Portland Cement
18	EABL
19	Equity Group
20	Eveready E. Africa
21	Express Kenya
22	Flame Tree Group
23	Housing Finance Group
24	Home Afrika
25	Homeboyz
26	I & M Holdings
27	Stanlib Fahari I-REIT
28	Jubilee Holdings
29	Kakuzi
30	Kapchorua Tea
31	KCB Group
32	KenGen
33	Kenya Airways
34	Kenya Orchards
35	KPLC
36	Kenya Re - Insurance Corporation
37	Kurwitu Ventures

38 Liberty Holdings
39 Limuru Tea
40 Longhorn Publishers
41 Mumias Sugar
42 Bank of Kigali
43 NSE
44 NMG
45 NCBA Group
46 Olympia Capital Holdings
47 Safaricom Plc
48 Sameer Africa
49 Sanlam Kenya
50 Sasini
51 Stanbic Holdings
52 Standard Chartered Bank
53 Standard Group
54 Co-operative Bank
55 Total Kenya
56 TPS E. Africa (Serena)
57 Trans - Century
58 Uchumi Limited
59 Umeme Ltd
60 Unga Group
61 Williamson Tea
62 Scangroup

Appendix II: Measurement and Operationalization of Financial Reporting Quality

Relevance		
	Item	**Measurement**
R1	Historical Cost (HC) versus Fair Value (FV)measurement	1 = HC only, 2 = Largely HC, 3 = symmetry/balance FV/HC, 4 = Largely FV 5 = FV only
R2	Opportunities and risks	1 = None, 2 = Scanty, 3 = Adequate, 4 = Greatly useful 5= Comprehensive
R3	How the risk section gives useful information on the entity's risk profile	1 = None, 2 = Scanty insights, 3 = Adequate , 4 = Lots of insights, 5 = Comprehensive
R4	Forward- looking information provision in the annual report	1 = None, 2 = Scanty , 3 = Adequate 4 = Lots of information, 5 = Comprehensive
R5	Information on CSR	1 = None, 2 = Scanty , 3 = Adequate, 4 = Lots of information on CSR, 5 = Comprehensive
R6	Extraordinary gains and losses-disclosure	1 = None, 2 = Scanty , 3 = Adequate , 4 = Lots of disclosure, 5 = Comprehensive
R7	Personnel policies information	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of information, 5 = Comprehensive
R8	Segmental Information disclosure	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of information, 5 = Comprehensive
R9	Cash-flow analysis	1 = None, 2 = Scanty, 3 = Adequate, 4 = Great analysis, 5 = Comprehensive
R10	Intangible assets disclosure	1 = None, 2 = Scanty, 3 = Adequate , 4 = Lots, 5 = Comprehensive
R11	Off-balance sheet disclosure	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of disclosure, 5 = Comprehensive
R12	Capital structure	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of disclosure, 5 = Comprehensive
R13	Entity’s going concern	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of information, 5 = Comprehensive

Faithful Representation		
	Item	**Measurement**
F1	Valid arguments for certain assumptions and estimates	1 = None, 2 = Scanty, 3 =Adequate, 4 = Lots of valid arguments, 5 = Comprehensive
2	Choice for certain accounting principles- disclosure of valid arguments	1 = None, 2 = Scanty, 3 =Adequate, 4 = Lots of valid arguments, 5 = Comprehensive
F3	Auditor`s report-Opinion	1 = Adverse, 2 = Disclaimer of opinion, 3 = Qualified, 4 = Unqualified opinion- figures, 5 = Unqualified opinion- figures + internal control
F4	Corporate governance disclosure	1 =None, 2 = Scanty, 3 = Adequate , 4 = Very much description, 5 = Comprehensive
F5	Comply or explain application	1 = None, 2 = Scanty, 3 =Adequate, 4 = Lots of valid arguments, 5 = Comprehensive
F6	Contingencies-positive & negative	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of disclosure, 5 = Comprehensive
F7	BOD bonuses information	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of information, 5 = Comprehensive
Understandability		
	Item	**Measurement**
U1	Presentation	1 = Very bad, 2 = Bad, 3 = Poor, 4 =Good presentation, 5 = Great
U2	Graphs and tables	1 = None, 2 = 1- 5 graphs, 3 = 6- 10 graphs, 4 = 11-15 graphs, 5 = > 15 graphs
U3	Technical jargon in the researcher`s opinion/perception	1 = Lots of jargon, 2 = Much jargon, 3 Average use of jargon, 4 = Scarce, 5 = None
U4	Glossary size-pages	1 = None, 2 = < 1 page, 3 = 1 page, 4 = 1- 2 pages, 5 = 2+ pages
U5	Vision, mission and strategy	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of information, 5 = Comprehensive
U6	Understandability in the researcher`s opinion/perception	1 = Very bad, 2 = Bad, 3 = Poor, 4 = Good, 5 = Great

Comparability		
	Item	**Measurement**
C1	Accounting policies disclosures changes	1 = None, 2 = Scanty, 3 = Adequate , 4 = Lots of disclosure, 5 = Comprehensive
C2	Accounting estimates disclosure changes.	1 = None, 2 = Scanty, 3 = Adequate, 4 = Lots of disclosure, 5 = Comprehensive
C3	Information about the effects of accounting policy changes, as well as a comparisons	1 = None, 2 = I year adjustment, 3 = 2 years, 4 = 3 years, 5 = 4 or more years
C4	Financial index figures and ratios.	1 = None, 2 = 1- 5 ratios, 3 = 6- 10 ratios, 4 = 11-15 ratios, 5 = 15+ ratios
C5	Information about the stocks/shares of entities	1 = None, 2 = Scanty, 3 = Adequate , 4 = Lots of information, 5 = Comprehensive
C6	Information on rivals' /competitors benchmarks	1 = None, 2 = Scanty , 3 = Adequate , 4 = Lots of information, 5 = Comprehensive
Timeliness		
	Item	**Measurement**
T1	The length of time (days) it took the auditor to sign the auditors' report following the conclusion of the fiscal year	Natural log of amount of days

Appendix III: Panel Data used in Data Analysis

Year	Company	FRQ	Prof (ROA)	Liq(Current Ratio)	Lev (Debt Ratio)	Siz (Log TA)	IFRS16
2017	Bamburi	3.6055	0.0448	1.6608	0.2967	7.6740	0.0000
2018	Bamburi	3.6063	0.0126	1.3206	0.3355	7.7021	0.0000
2019	Bamburi	3.6376	0.0093	1.3771	0.3456	7.6907	1.0000
2020	Bamburi	3.6376	0.0155	1.8112	0.3113	7.6941	1.0000
2017	BAT	3.5060	0.1838	1.3180	0.5597	7.2506	0.0000
2018	BAT	3.4437	0.2260	1.5911	0.4924	7.2634	0.0000
2019	BAT	3.5363	0.1930	1.0870	0.5571	7.3412	1.0000
2020	BAT	3.4755	0.2529	1.3044	0.4538	7.3366	1.0000
2017	BBK	3.5436	0.0261	0.3570	0.8376	8.4339	0.0000
2018	BBK	3.7860	0.0248	0.3340	0.8641	8.5123	0.0000
2019	BBK	3.5731	0.0213	0.3870	0.8795	8.5739	1.0000
2020	BBK	3.8168	0.0198	0.3980	0.8774	8.5791	1.0000
2017	BOC	3.6373	0.0177	1.9539	0.2771	6.3480	0.0000
2018	BOC	3.6082	0.0300	1.8836	0.2905	6.3308	0.0000
2019	BOC	3.6679	0.0270	1.9772	0.2776	6.2994	1.0000
2020	BOC	3.6376	0.0498	2.5137	0.2306	6.3200	1.0000
2017	BRITAM	3.4215	0.0057	1.6494	0.7711	7.9957	0.0000
2018	BRITAM	3.7254	-0.0220	1.4869	0.7689	8.0156	0.0000
2019	BRITAM	3.4534	0.0311	1.7361	0.7654	8.0978	1.0000
2020	BRITAM	3.7598	-0.0698	0.6000	0.8754	8.1366	1.0000
2017	Car & General	3.2446	0.0072	0.9951	0.6428	6.9731	0.0000
2018	Car & General	3.2395	0.0221	0.9903	0.6457	7.0075	0.0000
2019	Car & General	3.2423	0.0158	0.8731	0.6854	7.0601	0.0000
2020	Car & General	3.2749	0.0232	0.8655	0.6691	7.0757	1.0000
2017	Carbacid	2.7273	0.1103	6.8023	0.1158	6.5194	0.0000
2018	Carbacid	2.7253	0.0894	9.4280	0.0970	6.5278	0.0000
2019	Carbacid	2.7250	0.0755	5.6940	0.1073	6.5445	0.0000
2020	Carbacid	2.7591	0.0911	5.7630	0.1036	6.5596	1.0000
2017	Centum	3.8186	0.0874	0.5600	0.4402	7.9464	0.0000
2018	Centum	3.8187	0.0285	0.2056	0.4693	7.9836	0.0000
2019	Centum	3.8140	0.0449	0.2100	0.4932	8.0076	0.0000
2020	Centum	3.8489	0.0670	1.0390	0.4834	8.0080	1.0000
2017	CIC	3.3960	0.0171	0.6041	0.7496	7.4844	0.0000
2018	CIC	3.8807	0.0194	0.6633	0.7610	7.5182	0.0000
2019	CIC	3.4265	0.0094	0.6818	0.7776	7.5478	1.0000
2020	CIC	3.9114	0.0080	0.0100	0.8033	7.5887	1.0000
2017	Co-op	3.5438	0.0317	0.3380	0.8195	8.5876	0.0000
2018	Co-op	3.9377	0.0331	0.4110	0.8195	8.5876	0.0000
2019	Co-op	3.5723	0.0344	0.4620	0.8241	8.6600	1.0000
2020	Co-op	3.9683	0.0233	0.5220	0.8294	8.7300	1.0000
2017	Crown paints	3.5176	0.0409	1.1905	0.7007	6.7688	0.0000

2018	Crown paints	3.5164	0.0336	1.0129	0.8125	6.7384	0.0000
2019	Crown paints	3.5576	0.0577	0.9992	0.7632	6.7421	1.0000
2020	Crown paints	3.5533	0.1075	1.1878	0.6609	6.7506	1.0000
2017	DTB	3.4822	0.0187	0.4990	0.8524	8.5603	0.0000
2018	DTB	3.7550	0.0180	0.5620	0.8440	8.5772	0.0000
2019	DTB	3.5117	0.0178	0.5600	0.8330	8.5868	1.0000
2020	DTB	3.7856	0.0080	0.5630	0.8393	8.6284	1.0000
2017	EA Cables	3.3702	-0.0777	0.5992	0.7331	6.8475	0.0000
2018	EA Cables	3.3651	0.0824	0.7000	0.7331	6.8475	0.0000
2019	EA Cables	3.4038	0.1051	0.7176	0.6606	6.7976	1.0000
2020	EA Cables	3.3685	-0.0004	0.3705	0.9105	7.8464	1.0000
2017	EABL	3.5282	0.1160	1.0069	0.8202	7.8239	0.0000
2018	EABL	3.5277	0.1009	0.8349	0.8365	7.8528	0.0000
2019	EABL	3.5272	0.1122	0.8795	0.0476	7.9398	0.0000
2020	EABL	3.5595	0.0520	0.8630	0.6902	7.9398	1.0000
2017	EAPC	3.4284	-0.0538	0.3146	0.3826	7.4371	0.0000
2018	EAPC	3.4284	0.2385	0.2484	0.3506	7.5801	0.0000
2019	EAPC	3.4269	-0.0907	0.2624	0.4111	7.5628	0.0000
2020	EAPC	3.4587	-0.0772	0.1486	0.4669	7.5463	1.0000
2017	Equity Bank	3.4832	0.0378	0.5110	0.8224	8.7197	0.0000
2018	Equity Bank	3.5741	0.0359	0.5410	0.8344	8.7584	0.0000
2019	Equity Bank	3.5135	0.0359	0.5210	0.8341	8.8285	1.0000
2020	Equity Bank	3.6044	0.0234	0.5930	0.8634	9.0065	1.0000
2017	Eveready	3.3964	0.2880	2.6948	0.2890	5.8880	0.0000
2018	Eveready	3.3967	-0.1659	2.5325	0.2372	5.7587	0.0000
2019	Eveready	3.3966	-0.7383	1.5019	0.5574	5.3954	0.0000
2020	Eveready	3.4320	-0.1203	1.0396	0.7962	5.3034	1.0000
2017	Express Kenya	3.1536	-0.2443	0.5974	1.1866	5.5562	0.0000
2018	Express Kenya	3.1538	-0.2047	0.6187	1.4264	5.5064	0.0000
2019	Express Kenya	3.1916	-0.0549	1.4968	0.9370	5.6737	1.0000
2020	Express Kenya	3.1841	-0.0273	1.5344	0.5296	6.1278	1.0000
2017	Fig Tree Ltd	2.7284	0.0203	1.2907	0.5648	6.2255	0.0000
2018	Fig Tree Ltd	2.7290	0.0192	1.1436	0.5580	6.2646	0.0000
2019	Fig Tree Ltd	2.7296	0.0218	1.2125	0.5366	6.3582	0.0000
2020	Fig Tree Ltd	2.7572	0.0347	1.1099	0.5641	6.3960	1.0000
2017	Housing Finance	3.2406	0.0018	0.2070	0.8305	7.8296	0.0000
2018	Housing Finance	3.3012	-0.0093	0.2140	0.8287	7.7821	0.0000
2019	Housing Finance	3.2712	-0.0019	0.2080	0.8186	7.7517	1.0000
2020	Housing Finance	3.3319	-0.0305	0.2130	0.8456	7.7439	1.0000
2017	I & M Holdings	3.4821	0.0294	0.3600	0.8230	8.3067	0.0000
2018	I & M Holdings	3.4821	0.0324	0.4700	0.8237	8.4602	0.0000

2019	I & M Holdings	3.5129	0.0341	0.4600	0.8070	8.4987	1.0000
2020	I & M Holdings	3.5129	0.0240	0.4900	0.0597	0.8099	1.0000
2017	Jubilee Holdings	3.6974	0.0402	1.0800	0.7596	8.0211	0.0000
2018	Jubilee Holdings	3.6994	0.0347	1.0700	0.7541	8.0575	0.0000
2019	Jubilee Holdings	3.7317	0.0291	1.0600	0.7654	8.1142	1.0000
2020	Jubilee Holdings	3.7280	0.0263	1.0600	0.7564	8.1639	1.0000
2017	Kakuzi	2.9972	0.1095	3.9021	0.2478	6.7594	0.0000
2018	Kakuzi	2.7860	0.0824	5.9414	0.2140	6.7739	0.0000
2019	Kakuzi	3.0270	0.1151	11.003	0.1923	6.8103	1.0000
2020	Kakuzi	2.8147	0.0931	11.222	0.1941	6.8393	1.0000
2017	Kapchorua Tea	3.0289	-0.0248	3.4628	0.3028	6.3076	0.0000
2018	Kapchorua Tea	3.0337	0.0736	2.9197	0.3284	6.3960	0.0000
2019	Kapchorua Tea	3.0286	-0.0556	4.5125	0.2781	6.3082	0.0000
2020	Kapchorua Tea	3.0648	0.0098	4.8397	0.2652	6.2882	1.0000
2017	KCB	3.5400	0.0317	0.2900	0.8361	8.8107	0.0000
2018	KCB	3.9638	0.0353	0.3330	0.8409	8.8539	0.0000
2019	KCB	3.5711	0.0197	0.3710	0.8556	8.9536	1.0000
2020	KCB	4.0256	0.0208	0.4010	0.8558	8.9947	1.0000
2017	Kengen	3.8799	0.0243	1.4751	0.5144	8.5766	0.0000
2018	Kengen	3.8809	0.0209	1.5044	0.4989	8.5790	0.0000
2019	Kengen	3.8725	0.0202	1.3710	0.5143	8.6036	0.0000
2020	Kengen	3.9189	0.0451	1.9957	0.4882	8.6159	1.0000
2017	KPLC	3.5804	0.0227	0.8675	0.7952	8.5336	0.0000
2018	KPLC	3.5806	0.0057	0.5140	0.8093	8.5272	0.0000
2019	KPLC	3.5703	0.0008	2.3710	0.8286	8.5159	0.0000
2020	KPLC	3.6176	-0.0029	0.3629	0.8312	8.5122	1.0000
2017	KQ	3.5980	-0.0426	0.1964	1.3073	8.1648	0.0000
2018	KQ	3.5690	-0.0531	0.2160	0.9301	8.1749	0.0000
2019	KQ	3.6290	-0.0752	0.3784	1.0915	8.2915	1.0000
2020	KQ	3.5987	-0.1973	0.3184	1.3742	8.2342	1.0000
2017	Liberty Holdings	3.1497	0.0181	1.1865	0.7993	7.5722	0.0000
2018	Liberty Holdings	3.3676	0.0134	1.1777	0.7917	7.5632	0.0000
2019	Liberty Holdings	3.1868	0.0187	1.5135	0.7898	7.5823	1.0000
2020	Liberty Holdings	3.3946	0.0174	1.4800	0.7785	7.5944	1.0000
2017	NCBA	3.4516	0.0203	0.4823	0.8316	8.3142	0.0000
2018	NCBA	3.4523	0.0303	0.4746	0.8283	8.3189	0.0000
2019	NCBA	3.4827	0.0222	0.5183	0.8640	8.6944	1.0000
2020	NCBA	3.5130	0.0091	0.5506	0.8626	8.7225	1.0000
2017	NIC	3.5210	0.0204	0.6817	0.8273	8.3957	0.0000
2018	NIC	3.5082	0.0204	0.7527	0.8464	8.4633	0.0000
2019	NIC	3.5389	0.0219	0.5800	0.8670	8.4665	1.0000
2020	NIC	3.5476	0.0171	0.5600	0.8688	8.5038	1.0000
2017	NMG	3.4253	0.1111	2.0223	0.2786	7.0539	0.0000
2018	NMG	3.5160	0.0988	1.9536	0.2965	7.0491	0.0000
2019	NMG	3.4554	0.0729	1.9341	0.3554	7.0827	1.0000

2020	NMG	3.6002	0.0040	2.0402	0.3289	7.0726	1.0000
2017	Rea Vipingo	2.4881	0.1993	14.198	0.2141	6.6637	0.0000
2018	Rea Vipingo	2.3966	0.2804	7.6062	0.2588	6.7076	0.0000
2019	Rea Vipingo	2.5178	0.0734	8.4860	0.2476	6.7297	1.0000
2020	Rea Vipingo	2.4269	0.0637	9.0203	0.2396	6.7657	1.0000
2017	Safaricom	4.1694	0.3020	0.4642	0.3352	8.2087	0.0000
2018	Safaricom	4.1691	0.3360	0.6309	0.2599	8.2239	0.0000
2019	Safaricom	4.1668	0.3473	1.0800	0.2501	8.2844	0.0000
2020	Safaricom	4.1954	0.3631	0.3115	0.7990	8.3288	1.0000
2017	Sanlam	3.5436	0.0011	1.6617	0.8641	7.4744	0.0000
2018	Sanlam	3.5484	-0.0685	1.0888	0.9455	7.4639	0.0000
2019	Sanlam	3.5735	-0.0694	0.4754	0.9402	7.4629	1.0000
2020	Sanlam	3.5736	-0.0039	0.6400	0.9474	7.4986	1.0000
2017	Sasini	3.0615	0.0243	4.2407	0.1425	7.1204	0.0000
2018	Sasini	3.0577	0.0226	5.7625	0.1263	7.1127	0.0000
2019	Sasini	3.0575	-0.0230	4.2500	0.1219	7.1666	0.0000
2020	Sasini	3.0871	0.0015	5.7365	0.1046	7.1637	1.0000
2017	Stanchart	3.3609	0.0258	0.5873	0.8402	8.4559	0.0000
2018	Stanchart	3.3605	0.0284	0.6661	0.8366	8.4555	0.0000
2019	Stanchart	3.3905	0.0280	0.6257	0.8419	8.4802	1.0000
2020	Stanchart	3.3916	0.0173	0.7149	0.8437	8.5127	1.0000
2017	Standard Group	3.4205	-0.0612	0.8469	0.5820	6.6493	0.0000
2018	Standard Group	3.6629	0.0431	0.9120	0.5821	6.6699	0.0000
2019	Standard Group	3.4536	-0.1043	0.5969	0.7401	6.5518	1.0000
2020	Standard Group	3.6993	-0.0681	0.5072	0.7239	6.6080	1.0000
2017	Total	3.7293	0.0738	1.7356	0.4366	7.5799	0.0000
2018	Total	3.7903	0.0599	1.7713	0.4227	7.5939	0.0000
2019	Total	3.7600	0.0660	2.1529	0.3512	7.5745	1.0000
2020	Total	3.8206	0.0819	2.0533	0.3752	7.6333	1.0000

2017	TPS Serena	3.3948	0.0038	1.0792	0.4759	7.2427	0.0000
2018	TPS Serena	3.3958	0.0072	0.4338	0.4808	7.2455	0.0000
2019	TPS Serena	3.4262	0.0083	0.6649	0.4884	7.2549	1.0000
2020	TPS Serena	3.4261	-0.0652	0.6657	0.5227	7.2382	1.0000
2017	UNGA Group	3.5744	0.0040	1.6579	0.4807	6.9757	0.0000
2018	UNGA Group	2.8468	0.0525	2.1418	0.4353	6.9971	0.0000
2019	UNGA Group	3.6044	0.0333	1.9559	0.4312	7.0272	1.0000
2020	UNGA Group	2.8768	0.0025	2.4013	0.3681	7.2092	1.0000
2018	Williamson Tea	3.1247	0.0546	2.9855	0.2796	6.9780	0.0000
2019	Williamson Tea	3.1195	-0.0179	4.0362	0.2363	6.9176	0.0000
2020	Williamson Tea	3.1524	0.0164	3.9148	0.2233	6.8977	1.0000