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A Critical Examination on Corporate Governance Influence on Timely Financial Reporting By Kenyan Listed Manufacturing Firms

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Abstract

This study seeks to establish the effect of corporate governance on timely financial reporting of manufacturing firms listed at the Nairobi Securities Exchange. Among the key roles, which can be dealt with by corporate governance, is guaranteeing quality of the financial reporting process. The beginning point of the preparation of financial reporting is corporate governance. It utilized the descriptive research design in a bid to measure the data trends that exists in reference to the topic of study. The population of the study uses all 67 registered manufacturing firms at the Nairobi Securities Exchange, and secondary data gathered from the individual listed firm's annual reports and financial statements. The annual unit of analysis was used for the data analysis as data was collected on an annual basis from 2016 to 2020. Multiple linear regression and correlation analysis conducted, as correlation analysis established the strength and association firm size and corporate governance on the financial reporting of manufacturing firms at the Nairobi Securities Exchange. The study findings revealed that board independence, audit and risk committee, board size, and firm size do not have a significant correlation with financial reporting quality. Further study findings were that the model entailing corporate governance that include; board independence, audit and risk committee, and board size, as well as firm size, explains timely financial reporting to a very least extent with a coefficient of determination value of 2.04%. Additional study findings were that that the model entailing corporate governance that include; board independence, audit and risk committee, and board size, as well as firm size, does not significantly predict financial reporting quality. Final study findings were that board independence, audit and risk committee, board size, and firm size do not have a significant relationship with financial reporting quality.

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Empirically, the study has only utilized secondary data, the study can be followed by studies using primary data therefore, open to further investigations.

Keywords: Corporate governance; Financial reporting; Manufacturing firms.

1. Introduction

Earnings management stems from agency problems, the separation of management and ownership, and information asymmetry, management having comparative information over outsiders [13]. Reference [27] Use managerial opportunism to explain managements' discretionary behaviour in reporting earnings to influence contractual outcomes and thus affect wealth transfers. The authors in [10] provides evidence that managerial compensation and debt contracts have statistical significance in explaining accounting procedural choice of management. Owing to the widely publicized financial reporting frauds, regulators have reacted to this through making reforms on the corporate governance structures contending that the credibility of financing reporting is immensely improved by having strong corporate governance structures [13]. The authors in [5,6,29] while analysing governance structures shows that the probability of manipulation of earning is systematically associated with the weaknesses in the oversight of management such as lack of audit committee, Chief Executive Officer (CEO)-chairperson duality, and insider board membership domination. The financial reporting integrity however depends on other conduct and performance of financial reporting ecosystem member such as the management, auditors, and directors [9].

Good corporate governance by boards of directors influences the financial reporting quality, hence therefore in positive effects on investors' confidence [19]. The registered manufacturing firms at the Nairobi Securities Exchange (NSE) are, by legislations crafted by the capital markets regulator, the Capital Markets Authority (CMA), required to have sound corporate governance practices that fully comply with the international financial reporting standards that promote quality reporting that facilitates decision making by end users [21]. Kenya has encountered several scandals, which have led the dismissal of directors and liquidation of firms. These scandals depict that corporate governance is significant for the going concern of a company. For instance, the closure of Dubai bank and the placing of Imperial bank under receivership were as a result of the infringement of Central Bank regulation. The failures of these institutions necessitate the formulation and implementation of robust Corporate Governance policies [22]. Hence, an analysis of Corporate Governance by utilizing board composition and addressing its effect on timely financial reporting of listed manufacturing firm.

Equity holders are the major consumers of accounting information disclosed in the financial statements [5]. To uphold quality of the financial reports can be ensured by good corporate governance principles. Audit committees constantly strengthen the auditors' position in the quality of financial reporting [11], thus enhancing the auditors' standing with respect to excessive management behaviour, which may decrease the quality of reporting [8]. High quality financial reports are delivered when the internal and external auditors work together with the support of the audit and boards committees [11]. Among the key roles, which can be dealt with by corporate governance, is guaranteeing quality of the financial reporting process [11]. The beginning point of the preparation of financial reporting is corporate governance [19]. The relationship of the various parties in the

reporting field is key to attaining high quality financial reporting document.

Corporate governance failures have laid emphasis on the role of Enterprise Risk Management (ERM) in mitigating fraudulent reporting [12], this makes ERM a valuable component of governance structure, and it takes a holistic view of a firm's risk of which financial reporting is a component. Reference [24] In their study of ERM and accounting quality, find a positive association amongst adoption of ERM and quality of accounting and accounting information usefulness. The overall financial accounting and reporting framework in Kenya is guided by the Companies Act (CAP 486) and it outlines the minimum requirement of financial reporting. The acts mandates companies to provide financial accounts which indicates their true and fair view of their status, though it does not give the reporting standards which ought to be adopted. The mandate to give the guidelines on the accounting and auditing standards in Kenya are given to the Institute of Certified Public Accountants (ICPAK). ICPAK adopted the use of IFRS in the year 1999 and hence beginning 2000, companies in Kenya are mandated to comply with the IFRS.

Kenya has encountered several scandals, which have led the dismissal of directors and liquidation of firms. These scandals depict that corporate governance is significant for the going concern of a company. For instance, the closure of Dubai bank and the placing of Imperial bank under receivership were as a result of the infringement of Central Bank regulations. The failures of these institutions necessitate the formulation and implementation of robust Corporate Governance policies [28]. Authors in [16] in their study found that according to institutional investors, the financial reports quality in Kenya is rated between fair to good and this mean that there are improvements that are not yet attained in financial reporting. They further found out that financial reporting improved greatly by introduction of international accounting standards.

On the contrast, [24] revealed inconclusive findings on accounting quality improvement following adoption of IFRS in Kenya signifying related sentiment to that of investment community. Close to half of the Kenya listed manufacturing firms at NSE, have corporate governance failures therefore exposing the risk of capital loss that investors face. Equivalents of 44% cent of the listed firms have diversely breached corporate governance requirements such as transparency [6]. Hence, an analysis of corporate governance and addressing its effect on timely financial reporting of listed firms will be useful in addressing the failures of some companies listed in security exchanges. Reference [30] Established that corporate governance and timely financial reporting had significant influence on information. In the regional arena, Reference [1] established that large numbers of non-executive directors presents a significant negative threat to quality of financial reports. Reference [2] Established that there is a significant positive linkage between corporate governance mechanisms and financial reporting quality. Reference [4] Established that board size and independence had an insignificant effect on quality of financial reporting. Reference [17] indicated that family shareholding, block shareholding, and foreign ownership reduces the financial information quality and the control by governments and financial institutions exhibited good quality financial disclosure. In the local scene, Reference [20] revealed a strong positive linkage in value of the firm and timely financial reporting index. Reference [25] Established that board size and audit committee presence had significant and positive effects on the timely financial reporting but board independence and frequency of board meetings exhibited significant and negative effects on financial reporting quality. Reference [23] Indicated the existence of significant and positive linkages between reporting

quality and financial performance. Reference [18] Showed that adoption of IFRS has positively and significantly enhanced the financial reporting quality. The studies reviewed did not include all the aspects of corporate governance highlighted in the current study that entailed; board independence, presence of audit board committee, and board size. The studies reviewed did not also utilize discretionary accruals as a measure of financial reporting quality. These present a conceptual gap. The studies by [30, 20, 23, 18] did not relate corporate governance to timely financial reporting thus also presenting a conceptual gap. The global and regional studies reviewed in this section were not done in the Kenyan context thus presenting a contextual" gap.

2. Method

The study utilized the descriptive research design in a bid to measure the data trends that exists in reference to the topic of study. According to [14] the descriptive method gives the researcher a way to compare and contrast the different types of data in order to ascertain the trends that exist therein. The study chose the descriptive research design since it could be used to describe different phenomenon and their characteristics.

Target Population

In this study, the population of the study was all 67 registered manufacturing firms at the Nairobi Securities Exchange. Since all the whole population was examined, the study was a census. Reference [29] Refers population to the total number of individuals or people in a study. The population normally has characteristics that are alike. Reference [15] Opines that a grouping of elements, events, or people, which are being examined with the goal being provision of answer to research question, denotes a study population.

Data Collection

The secondary data was gathered from the individual listed firm's annual reports and financial statements. The annual unit of analysis was used. Data was collected on an annual basis from 2016 to 2020. Data on; net income, cash flows from operations, total assets, number of independent directors, total directors in the board, and presence/absence of an audit committee was gathered.

Data Analysis

Multiple linear regression and correlation analysis was done. Correlation analysis was able to establish the strength and association firm size and corporate governance on the FR of manufacturing firms at the Nairobi Securities Exchange. On the other hand, regression analysis was used to establish the significance of the association amongst the study variables. The 95% confidence level was used to test the model significance. The significance values determined how the predictor variables relate to the response variables.

3. Results

Correlation analysis indicates the relationship that exists between two variables. The association varies from strong negative correlation to perfect positive correlation. The researcher employed the Pearson correlation

analysis to establish the association of the independent and control variables utilized in the study. The study was applied at 95% confidence level and a two tail test was used.

Table1: Correlation Analysis.

	Financ~y	BoardI~e	LnAudi~e	LnBoar~e	LnFirm~e
FinancialR~y	1.0000				
BoardIndip~e	0.0032	1.0000			
	0.9568				
LnAuditand~e	-0.0458	0.0927	1.0000		
	0.4442	0.1209			
LnBoardSize	-0.0361	0.1115	0.6212*	1.0000	
	0.5465	0.0619	0.0000		
LnFirmSize	-0.0200	0.0659	0.5750*	0.4449*	1.0000
	0.7390	0.2713	0.0000	0.0000	

As shown in table 1, with significance level at 5%, board independence, audit and risk committee, board size, and firm size do not have a significant correlation with timely financial reporting at the 5% significance level. This is because its significance value is greater than the study's critical value (α=0.05). The effect of the corporate governance aspects entailing; board independence, audit and risk committee, and board size on timely financial reporting was established through the random effect panel multiple regression analysis which was undertaken at the significance level of 5%. The researcher compared the significance value shown in the ANOVA model with those got from the study. The significance values obtained for the model coefficients were also compared to the significance value of 0.05. Table 2 exhibits the findings.

Table 2: Fixed Effects Panel Multiple Linear Regression.

Random-effects GLS regression	Number of obs = 223
Group variable: Number	Number of groups = 58
R-sq: within = 0.0273	Obs per group: min = 1
between = 0.0020	avg = 3.8
overall = 0.0204	max = 4
	Wald chi2(4) = 23.73
corr(u_i, X) = 0 (assumed)	Prob > chi2 = 0.0001

(Std. Err. adjusted for 58 clusters in Number)

dzFinRepQual	Coef.	Robust Std. Err.	z	P>|z|	[95% Conf.	Interval]
dzBoardInd	.0073708	.0067758	1.09	0.277	-.0059096	.0206512
dAud_and_R~e	-.7733419	1.058026	-0.73	0.465	-2.847036	1.300352
dzBoardSize	-.716676	.4691154	-1.53	0.127	-1.636125	.2027734
dzFirmSize	.6086764	.6467972	0.94	0.347	-.6590229	1.876376
_cons	.0154923	.0514118	0.30	0.763	-.085273	.1162576
sigma_u	0					
sigma_e	1.2032758					
rho	0	(fraction of variance due to u_i)				

Prior to carrying out the multiple linear regression analysis, the variables had to be modified as the normality, homoscedasticity, and stationarity criteria were not met. Since all the variables used in the current study, apart from audit and risk committee, did not meet the normality condition, they were standardised in order to correct the non-normality. The "robust standard errors'" approach for identifying unbiased standard errors in OLS coefficients during heteroscedasticity was used because of the data series of predictors used during the current study showing heteroscedasticity. Finally, the data series of all the variables was first differentiated as unit root remedy.

The R^2 indicates that the variations in the dependent variable (financial reporting quality) which emanates from the changes in the independent variables. The overall R^2 value from the findings is 0.0204 which implies that 2.04% of timely financial reporting changes are as a result of changes in the model entailing corporate governance aspects that include; board independence, audit and risk committee, and board size, as well as firm size. This implied that other variables which are not incorporated in the model are attributable to the 97.96% of the changes in financial reporting quality.

Table 2 further illustrates that the model entailing corporate governance that include; board independence, audit and risk committee, and board size, as well as firm size, significantly predicts financial reporting quality. This is because the significance value obtained for the model (Prob> chi2=0.0000) is less than the study critical value (α=0.05).

The results in Table 2 finally demonstrates that board independence, audit and risk committee, board size, and firm size do not have a significant relationship with financial reporting quality. This is because their respective significance levels are greater than the study critical value (α=0.05).

4. Discussion, Conclusion and Recommendations

The study findings established that board independence, audit and risk committee, board size, and firm size do not have a significant correlation with timely financial reporting at the 5% significance level. Further study findings established that the model entailing; entailing corporate governance that include; board independence, audit and risk committee, and board size, as well as firm size, explains timely financial reporting to a very least extent with a coefficient of determination value of 2.04%. [12] While analyzing governance structures shows that the probability of manipulation of earning is systematically associated with the weaknesses in the oversight of management such as lack of audit committee and insider board membership domination. The study findings that board independence and audit and risk committee do not have a significant impact on timely financial reporting is not congruent to these assertion.

Among the key roles, which can be dealt with by corporate governance, is guaranteeing quality of the financial reporting process [11]. The beginning point of the preparation of financial reporting is corporate governance [26] the study found that corporate governance has a significant impact on timely financial reporting which is parallel to these assertions. The relationship of the various parties in the reporting field is key to attaining high quality financial reporting document. For instance, the composition and characteristics of the audit committee

and board is related with the quality of financing reporting because this two elements of corporate governance aid in overseeing the top management [16]. The study found that board independence, audit and risk committee, and board size do not have a significant impact on timely financial reporting is not congruent to this assertion.

Audit committees constantly strengthen the auditors' position in the quality of financial reporting [16], thus enhancing the auditors' standing with respect to excessive management behavior, which may decrease the quality of reporting [8]. High quality financial reports are delivered when the internal and external auditors work together with the support of the audit and boards committees [16]. The study found that the audit and risk committee does not have a significant impact on timely financial reporting and is not in tandem to this assertions. In comparison to outsourced Internal Audit Function (IAF) which reports to the audit committee, the possibility of an in house IAF to prevent financial reporting fraud when reporting to the board is lower even though cases of fraud will be reported if found [15]. The advantage of IAF is that it assists in reducing the opportunistic behaviours of management and as a result affected the quality of financial reporting by an entity. Internal audit function performs the traditional monitoring function which as a result translates to improve timely financial reporting [27]. The study also found that the audit and risk committee does not have a significant impact on timely financial reporting and is not in tandem to this assertions.

The authors in [30] conducted a research aimed on establishing the how profitability and corporate governance affected earning management in the context of manufacturing firms listed in SGX and BEI. The research findings indicated a significant influence on financial reporting by Corporate Governance (CG). The current study found that corporate governance has a significant impact on timely financial reporting and is parallel to this finding. Reference [5] Did an examination of the association amongst information content of earnings, earnings response coefficients and board and audit committee structure. The study findings established that the higher the independence of the full board the more informative the earnings were. Further, the study revealed that audit committee characteristics have an effect on the earnings information.and particularly in firms whose audit committee composition is small, thus the earnings are more informative. The study findings are that board independence and audit and risk committee do not have a significant impact on timely financial reporting is not in tandem to this findings.

Researchers in [14] analyzed the association amongst the likelihood of a firm having an unqualified report as a proxy for financial reports quality and the audit committees' characteristics. This was done at the public shareholding Industrial Companies Listed at Amman Bourse. The study revealed that the audit committee size positively affected the financial expertise of its member on the external auditors' report. The ownership of the members of the audit committee in the share of the business in the external auditor's report has, on the other hand, had a negative effect. Further, there was no effect of the independence of members of the audit committee on the type of auditor's report. The study findings that board independence and audit and risk committee do not have a significant impact on timely financial reporting is not in tandem to these findings.

Reference [1] Did a research on effects of board attributes and audit quality on financial reporting of quoted food product companies in Nigeria. The population was all the nine food product companies. The study findings exhibited a positive but insignificant link between board size, audit committee size, and audit committee tenure

in isolation, and financial reporting of the quoted food manufacturing companies in Nigeria. The study found that board independence, audit and risk committee, and board size do not have a significant impact on timely financial reporting and is not in tandem to these findings. Reference [2] conducted a study on corporate governance and timely financial reporting in Nigeria. The population was 40 companies listed on the Nigeria Stock Exchange. The study established a significant positive association amongst corporate governance mechanisms and QFR in the companies listed on the Nigeria Stock Exchange. The current study found that corporate governance has a significant impact on timely financial reporting is congruent to this finding.

Authors in [22] did an examination on the effect of corporate governance on timeliness of financial reporting of firms registered at the NSE. The study population was all 60 firms listed at the NSE. The research findings exhibited that variation in the corporate governance mechanisms, specifically increase in board size, negatively affected the timeliness of financial reporting. The current study found that corporate governance has a significant impact on timely financial reporting is in tandem to this finding. The additional study finding that board size does not have a significant relationship with timely financial reporting is not congruent this finding

The study concluded that corporate governance significantly impacts on financial reporting quality. The study's also specifically aimed at unravelling the impact of the corporate governance aspects entailing; board independence, audit and risk committee, and board size, as well as firm size, on the timely financial reporting of firms listed at the Nairobi Securities Exchange. The study concluded that board independence, audit and risk committee, board size, firm size neither have a significant association nor relationship with financial reporting quality.

Those who will conduct future research in the area of finance will benefit from the results of this study in regards to corporate governance and financial reporting. Subsequent researchers interested in corporate governance and financial reporting will use the study results as a reference. The study will bring about financial reporting and minimization of fraud. Similarly, the work will provide resourceful material for future scholars and researcher interested in the subject of corporate governance and financial reporting quality.

Policy recommendations are made to the government officials and policy formulators in the financial sector, mainly the regulator, the Capital Markets Authority (CMA), and the Treasury, that since it has been established that corporate governance has a significant influence on financial reporting quality, the policy makers should utilize corporate governance when endeavouring to boost financial reporting quality, and by extension fraud, in order to boost the credibility of the capital markets. The research project findings will serve as a road-map for key government bodies and authorities as they develop policies and procedures to strengthen the financial sector. The current study findings will provide empirical findings to the government and other relevant agency to help guide the formulation and implementation of relevant policies and regulation.

The finding of the study that corporate governance has a significant influence on financial reporting generates recommendations to the financial analysts to utilize corporate governance when analysing the financial statements of listed manufacturing firms when trying to estimate their intrinsic values. Henceforth, this study will offer them immeasurable insights, which will help them when advising their clients. Additionally, the

current study findings that corporate governance has a significant influence on financial reporting generates recommendations to consultants and listed firms practitioners to utilize corporate governance when trying to bolster timely financial reporting and minimize the principle-agent conflict.

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