

**THE EFFECT OF IMPLEMENTATION OF IFRS 9 ON THE FINANCIAL  
PERFORMANCE OF LISTED COMMERCIAL BANKS IN KENYA.**

**BY**

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**A Management Research Project Submitted to the Strathmore University Business School  
in Partial Fulfilment of the Degree of Bachelor of Commerce from Strathmore University**

**December, 2019**

## DECLARATION

### STUDENT'S DECLARATION

I declare that this research project is my original work and it has not been previously submitted and approved for the award of a degree in this or any other University. To the best of my knowledge, it contains no material previously written or published by another author except where due reference has been made in the project itself.

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## **ACKNOWLEDGEMENTS**

I would like to express immense appreciation to the Almighty God for giving me patience and resilience through this academic journey up until now. Great gratitude goes out to my supervisor Mr Lincoln Ndwiga Njiru from the bottom of my heart for the guidance and constructive feedback he has given me. Finally, I would like to thank my parents and friends for their continuous support and encouragement.

## ABSTRACT

The study seeks to explain the IFRS 9 standard and its effect on the financial performance of the listed commercial banks in Kenya. The financial performance, in this case, will be based on profitability and liquidity. The standard introduces a new Expected Credit Loss Model (ECL) that with supervisory guidelines that were implemented on the mandatory date of 1<sup>st</sup> January 2018. The model includes earlier and bigger impairment losses which minimize the losses incurred and more effective market discipline. However, the model creates additional space for managerial discretion through the volatility of the regulatory capital. This gives the executives a chance to behave in an opportunistic behaviour which can compromise the integrity of the financial disclosures (Novotny-Farkas, 2016). This study used a sample size of 11 respondents. These comprised of the 11 listed commercial banks in Kenya. This study applied the correlational and descriptive analysis of the quantitative and qualitative data retrieved. The response rate totalled to 81% which is considered sufficient for data analysis. The data of the study were collected through questionnaires for the primary data and financial disclosures of the commercial banks. The data was analysed through Excel, Annova. The findings of the study revealed that the standard does has a little effect on the liquidity due to the recognition and recognition of the assets as well as profitability as the standard strives to minimize losses made. However, the effect is not substantial it can be seen.

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## LIST OF ABBREVIATIONS

<b>IFRS</b>	International Financial Reporting Standards
<b>IASB</b>	International Accounting Standards Board
<b>SBM</b>	State Bank of Mauritius
<b>CBA</b>	Commercial Bank of Africa
<b>ICPAK</b>	Institute of Certified Public Accountants
<b>CBK</b>	Central Bank of Africa
<b>ECL</b>	Expected Credit Losses
<b>PAT</b>	Positive Accounting Theory
<b>GAAP</b>	General Accepted Accounting Principles
<b>IAH</b>	International Accounting Harmonization
<b>NSE</b>	Nairobi Securities Exchange
<b>IT</b>	Information Technology

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## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background Study

Accounting is known as the method in which the performance and financial position of corporate companies are relayed to the world. Accounting standards simplify the accounting procedures by using a common reporting language globally. IFRS adoption is known and understood by most if not all international investors. With the introduction of globalization, worldwide capital markets have witnessed rapid expansion, diversification and, integration in Europe. This led to the shift from local financial reporting to global standards which resulted to the European Commission issuing legislation which required the use of the International Accounting Standard Board (IASB) for all listed companies in 2005, thus making IFRS mandatory (Abebe, 2018)

According to Odia.J.O (2013), the adoption of the IFRS standards has been an important change not only in Africa but globally over the years. It continues to develop around the world as more countries use it and combine their own standards with the official standards. Though some tend to think that it is irrelevant to developing countries while others think it is beneficial to these developing countries as it has added more value to people who continue to use it. It is also considered to be superior to the local accounting standards that companies use as it helps with the comparability of financial statements by prospective investors. Some factors that have led to the adoption of IFRS include globalization, foreign investment and, aids as well as increased border-listing.

Abebe (2018) added to the fact that the objective of financial reporting is to readily provide information for decision making. Variances encountered in financial reporting may result from dissimilar legal and tax systems as well as different business models. The standard's goal is to eliminate the variance by synchronizing the financial information and increase in comparability. This will also assist in analyzing the financial information and promotion of efficient collaboration of resources and reduction in capital cost. Multiple countries identified the need for quality

financial reporting and other benefits such as the development of comparability of financial information, excellent reporting due to transparency, entities knowing their true worth, accessibility to global capital markets resulting to enhanced quality and harmonious financial reporting.

International Financial Reporting Standards 9 shows how a firm should group and measure its assets, liabilities as well as purchase or sale of non-financial commodities. The standard requires an organization to recognize the assets and liabilities when they become in line with the requirements of the instrument. Upon initial recognition, a company measures the asset or liability at fair value. In a situation not at fair value along with profit or loss, transaction costs are immediately linked to the acquiring or disclosing of the asset or liability (Standards, 2017). The implementation of the standard has indeed affected the financials of various entities that have implemented it. Especially after the mandatory implementation dated January 1<sup>st</sup>, 2018.

Due to the financial crisis affecting international financial reporting standards, the IASB formulated a standard for the financial instruments. The change leads to the view of accounting information in financial statements, especially banks, and financial institutions as they are deemed to be pillars of the economy as they represent the economical state of a region. Past prices are linked to the future behaviour of the prices and are based on the business processes of the firm and not managerial decisions. The change of standards had an important effect on the accounting practices, decision-making practices and ultimately disclosures of the financial statements. This article presents the comparison between standards, its pros and cons, a fair value accounting, impairment of financial instruments and changes in decision making in the organizations. (Gornjak, 2017).

### **1.1.1 Commercial Banks in Kenya**

Kenya has about forty commercial banks that are currently running. The country has experienced many cases of mergers and acquisitions. For example, chase bank and the Mauritius bank, SBM as well as NIC group with Commercial Bank of Africa (CBA) which is the most recent case among other cases within the last four years. CBA also had plans to take over Jamii Bora bank. Since the

adoption of IFRS 9, the commercial banks were required to avail both incurred and expected credit losses. Many banks charged a one-off impairment on their equity which was permitted in the first financial period of adoption. Banks used more strict credit policies which led to lending leaning towards secured lending as opposed to non-collateral based lending. The commercial banks became more welcoming to lending SMEs than lending to the private sector to earn higher returns with less risk and escape the necessity of high provisioning levels. The commercial banks have been borrowing more from global institutions in order to lend to the private sectors and SMEs by filling out the shortage of funds which was brought about by the contradiction in their assets and liabilities i.e. short term deposits with long term loans (Cyttonn, 2019).

With the increase in mergers and acquisitions, the implementation will simplify the analysis of the financial disclosures as well as comparability. This is because local and personal accounting methods are replaced with these common accounting standards reducing any complications and making it easier for auditors as well as investors to understand the financial statements. The mismatch of assets and liabilities is also reduced as the IFRS 9 focuses on the measurement procedures of the company's assets which will be linked to the structure of the firm. As for the measurement of the liabilities, credit assessment will be altered and formulated as per projected economic conditions of the industry. These changes will ultimately affect the financial disclosures in a positive manner as all commercial banks are expected to follow the standard's format. Below is a summary of listed banks as well as their total return in the year 2018;

**Table 1.1 Valuation summary of listed banks in Kenya, 2018**

<b>Bank</b>	<b>Dividend yield (%)</b>	<b>Total return (%)</b>
Diamond Trust Bank	2.0	87.8
Equity Group	5.1	53.0
I&M Holdings	3.0	48.8
KCB Group	7.8	41.2
Co-operative Bank	7.1	37.7
NIC Group	3.4	36.0

Stanbic Holdings	5.9	22.7
Barclays Bank	9.2	19.1
National Bank of Kenya	0.0	10.8
Standard Chartered Bank of Kenya	8.8	8.1
HF Group	0.0	(31.8)

### 1.1.2 Regulatory Authorities

According to Njiru (2018) from the Institute of Certified Public Accountants (ICPAK), the adoption of the new standard will widely influence the credit impairment provisions as well as the profit. It is also expected to affect the financial disclosures as extensive and thorough disclosures will be required. It is estimated that the new standard will affect the Kenyan banking sector in the recognition and additional provisions, disclosures, the statutory loan reserve and the transitional period. Under the statutory loan reserve, the Central Bank Loan provisions are higher than the IFRS 9 provisions, the surplus provision will be an appropriation of retained earnings. The surplus will be credited to the loan reserve as required by the CBK Risk Classification of assets and provisioning.

M'mbijewe (2018), the Deputy Governor of the Central Bank of Kenya stated that the commercial banks in Kenya will continue to plan on how to efficiently grow capital in an effective manner during the five year transition period. The banks are therefore expected to follow the guidelines released by the CBK. The banks together with their auditors are in charge of the adoption but the ICPAK will oversee the implementation as the regulators of the professional auditing bodies. To avoid any instability, the commercial banks are encouraged to be flexible and align themselves to the conditions when necessary. The commercial banks are also encouraged to provide efficient disclosures of the financial statements once the standard has been implemented. CBK will partner with ICPAK and KBA (Kenya Bankers Association) to provide sufficient guidelines for the implementation of the new standard to make it bearable.

## **1.2 Scope of the Study**

IFRS 9 ensures that the measurement procedures of the financial assets are in line with the business structure of the firm as well as the contractual cash flow of the commodities and projected economic conditions. Moreover, the IFRS 9 provision for the substructure will lead organizations to assess how the economic conditions and credit alterations will affect the business structures, portfolios and provisions under the stated scenarios (Gea-Carrasco, 2015). This meant that the banks were expected to adjust and change the way they carry out their business activities i.e. allocation of capital and manage the quality of loan and provisions at origination. The replacement of IAS 39 with IFRS 9 has greatly affected the bank's financial documents and impaired statements. Taylor (2006) stated that IAS 39 availed provided better accuracy in the evaluation of the riskiness of firms and their valued assets.

According to IFRS 9 — Financial Instruments (2019), on 12<sup>th</sup> November 2009, the IASB issued IFRS 9 Financial instruments as the first initiative to replace IAS 39. On 28<sup>th</sup> October 2010, the Board republished IFRS 9, adding to it new essentials for financial liabilities. On 16<sup>th</sup> December 2011, the Board published a Mandatory Effective Date and Transition Disclosures, which corrected the date of implementation to annual periods beginning on or after 1<sup>st</sup> January 2015. On 19<sup>th</sup> November 2013, the IASB published IFRS 9 changing it to include the latest general hedge accounting framework, permitting early adoption of the fair value alterations because of personal credit on liabilities designated at fair value through profit or loss and removed the 1<sup>st</sup> January effective date. On 24<sup>th</sup> July, the Board published the final version of IFRS 9 adding the latest impairment framework for expected losses and adding limited amendments to the classification and measurement requirements for financial assets.

## **1.3 The Problem Statement**

Onali & Ginesti (2014) found that prospective investors and shareholders did not seem indifferent to the adoption of the new standard, especially in areas with a weaker rule of law and the weaker difference between the local accounting standards and the IAS 39. This also indicates that investors and shareholders rely more on IFRS 9 to focus on the issues that the previous standard could not address although countries are expected to have different outcomes due to the different tax, legal

and business systems. It was also found that better comparability between the countries is more important than the costs of poorer firm-specific information for which the difference between the local accounting standards and IAS 39 is small.

In addition to that, Beerbaum (2015) found that the IFRS 9 was introduced in response to the financial crisis and requires a three-step approach, which replaces the current incurred impairment model with a new expected loss model. The first step is the initial recognition. Financial assets are included, which are exposed to low credit risk, a 12 month expected credit losses (ECL) is calculated. A significant increase in credit risk cannot be measured at initial recognition. In the second stage, financial instruments which are exposed to a significant increase in credit risk are included, lifetime ECL is recognized. At the third stage, financial assets for which objective evidence of impairment at the reporting date has taken place, lifetime ECL is recognized and interest revenue is calculated on the net carrying amount. It was therefore concluded that the new standard will have a great impact on the financial institutions' bank systems and processes as well as a tightening effect on earnings management. Therefore, regulators of the institutions are required to provide guidance to avoid completely different models resulting in decreasing comparability for regulators and investors.

According to Novotny-Farkas (2016), IFRS 9 includes more information on identifying future ECLs and in turn early recognition for these ECLs. It also focusses on supervisory concerns. The standard can reduce any large effects of the incurred loss approach on procyclicality and reduce capital inadequacy concerns during a crisis. Moreover, the earlier reporting of ECLs and extended disclosures requirements better the transparency and efficiency of the market discipline. This improvement contributes to financial stability. In addition to the standard promoting stability to firms, it is also quite complex and difficult to understand which can prove to be a stumbling block for most accountants as they strive to implement the accounting standard.

Teymurov (2017) found that IFRS 9 introduced new forward-looking models which proved to be the main challenge. In addition to the analysis of the quality of borrowers, the new approach will involve macro-economic factors. This will require the banks to develop/attract new skills and knowledge to the sector. Moreover, there is a new classification approach for financial instruments

as well as changes to hedge accounting. The aspect of all financial institutions having to adopt this standard all over the world can be quite complex due to the different situations such as the different economic environments and political stability.

The implementation of IFRS 9 was crucial as it was an improvement that the IASB made from IAS 39. This study wants to evaluate the reason for the replacement as well as its impact on the financial performance, the reaction of the stakeholders, investors and the market in general. The role of the investors and shareholders on the implementation will also be evaluated. The standard is based on the classification and measurement of financial assets as well as the introduction of a new expected-loss impairment framework among other accounting practices that it touches on. Because of this, it is evident that the financial decisions and performance of entities will be affected. The project will look at the change in the financial performance of the commercial banks after the adoption of the standard.

From the previous research papers, few have really brought out the impact or the extent of adoption in listed commercial banks in Kenya. It has mainly been theoretical projections of the impact in other regions. This proposal wants to evaluate and show practically the impact of the implementation especially after the first year of the mandatory implementation. Due to the mandatory implementation, there are more banks to observe and evaluate the effect on the financial performance based on various factors such as the implications of corporate governance, the extent of adoption as well as the overall effects that have developed over the first year.

#### **1.4 Research Objectives**

The following are the research objectives of this report, that it wishes to achieve by the end of the report:

- i. To determine the effect of IFRS 9 on the profitability of the listed commercial banks in Kenya.
- ii. To determine the effect of IFRS 9 on the liquidity of the listed commercial banks in Kenya.
- iii. To establish the benefits and challenges experienced by the listed commercial banks while adopting the standard.

The research questions for investigations are outlined below:

- i. What is the effect of IFRS 9 on the profitability of the listed commercial banks?
- ii. What is the effect of IFRS 9 on the liquidity of the listed commercial banks?
- iii. What are the benefits and challenges of adopting the standard?

### **1.5 Significance of the Study**

The study will strive to assist those who wish to enter the financial/banking sector understand the standard better and try to assist in future decision making after establishing the standard's benefits as well as the challenges faced. Other than the listed banks, this study can be used by other banks/financial institutions to gain a better understanding of IFRS 9 and its reason for implementation.

This study is important as it will shed more light on the importance of the implementation of the standard. Previous standards used were good but not as efficient when it came to ensuring stability and transparency when it came to formulating financials of a firm. IFRS 9 is considered to have the latter stated ensured. We will, therefore, study how it has been implemented and the changes it has effected in the financial statements of the listed banks in Kenya.

Due to its complex nature, accountants and financial advisors may have had some difficulty in understanding and implementing the standard. This study will look at its complex nature in detail and try to pick out the problems that may have been faced and how they were tackled after the first year of implementation. Aside from the challenges faced, the study will identify the benefits it provides to the accountants and firms.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

This study worked towards determining the effect of IFRS 9 adoption on a company in general, companies, in this case, were the listed commercial banks in Kenya. In order to accurately define this relationship, the study looked at theories touching on the effects of the standard on profitability and liquidity as well as the challenges encountered during the adoption of this standard. It also looked at existing studies that focus on IFRS adoption to give a deeper explanation on the variables of the study, the conceptual framework, as well as the gaps found, that this study will try to fill.

#### 2.2 Theoretical Foundation of the Study

This study focused on two theories that explain the importance, benefits and challenges with the adoption of the standard. These theories include agency theory and positive accounting theory.

##### 2.2.1 Agency Theory

Leung & Ilsever (2013) defined agency theory as a contractual relationship between the agent and the principal under which the agent has the mandate to perform duties for the principal. The agent is the director and the principal is the shareholder. The duty, in this case, can be the delegation of decision making on behalf of the principal. As information asymmetry is realized by the agent between both parties, they both take actions that are in their own self-interest. After the realization of this problem, the principal sorts out to realign his wants to that of the agents through incentives and incur costs that are attributable to the minimization of the opportunistic behaviour of the directors. The main source of agency problem is from the separation of power and operational control of the entity. Transparency in the disclosure of financial statements is the main reduction source of information asymmetry. Financial reporting of the statements is a fundamental practice of corporate disclosure. The researchers added that agency costs will be reduced with disclosure regulation which brings the aspect of economies of scale. This is because regulation will lead to

efficiency gains by minimization of replication of information and improve comparability of the financial statements of different entities.

Ferrer & Ferrer (2011) argue that the managers and directors are the ones with the real picture of the value of the company more than the shareholders bringing the aspect of information asymmetry. To minimize the impact of the information asymmetry, disclosure of the financial statements which contain the condition of the company based on its financial stability. Through the financial disclosures the stakeholders are fully aware of the financial condition and value of the entity through ratios such as return on equity, earnings per share, return on equity, return on sales and the level of International Financial Reporting Standard. In this case, the level of profitability is based on IFRS and is measured and regressed through linear regression in comparison to other listed entities.

Agency theory explains how information asymmetry between shareholders, creditors and managers can be minimized through measures such as monitoring the opportunistic behaviour. If the shareholders and creditors refrain from monitoring the company risk, they will introduce monitoring activities that will improve the flow of information and minimize uncertainty. Without the mechanisms, managers will be more likely to behave opportunistically by eliminating crucial information or by manipulating the financial disclosures in order to fulfil their own self-interests. Şenyiğit (2014) added that debt is crucial in the firms' commitment to financial reporting transparency. The superior quality of financial disclosures minimizes agency costs that come to the debt contracting process. Entities that implement the standard voluntarily reduce the costs associated with debt and increase the capital pool as the superior quality and high earnings attract investors.

### **2.2.2 Positive Accounting Theory**

According to Whittington (1987), positive accounting theory (PAT) seeks to apply and predict suitable accounting practices. It focusses on explaining the accounting practises as well as predicting and evaluating the behaviour. Klefvenberg & Norlander (2015) argued that accounting is a contractual agreement between an agent and the principal. The contractual agreement is the

determinant of the accounting principle to be used. The principal, however, will greatly influence the decision of the agent on the accounting principle to be chosen simply because they want a standard that will benefit the principals. The agent will also assume a standard that will benefit them at best and ignore the principal's interests, they can do this by also trying to influence the process of picking the most suitable accounting standard.

PAT looks at possible economic consequences that play a role in determining a suitable accounting standard. Human behaviour can be explained in this case as they have wealth maximizing behaviour. Therefore, the actors in this theory (the agent and principal) must decide on the level of investment by considering the competence of the standard and information asymmetry of the market conditions. PAT is based on the fact that a specific set of guidelines should be formulated in order to achieve successful accounting implementation and practices. The term positive is derived from the fact that it deals with real figures as opposed to the Normative Theory which suggests that prescriptions should be followed rather than the fixed guidelines as suggested by PAT (Collin *et al*, 2009)

Watts & Zimmerman (1990) concluded that the theory provides a substructure of forecasting accounting choices that are not made in terms of better measurement of some accounting procedures such as earnings but are made because of personal objectives and the impact the standards have on the achievement of those objectives. They further concluded that the positive accounting theory also included the importance of contracting costs (information, agency and lobbying costs). Accounting methods do not exist without contracting costs, the positive accounting theory has incorporated these costs and their importance when explaining accounting choices.

According to Barlev & Haddad (2007), financial accounting and regulatory boards that formulate the standards are regarded as important when it comes to accounting information and comparability. Therefore, the goal of International Accounting Harmonization (IAH) is to minimize the deviations in accounting procedures as they are greatly linked to the comparability aspect of accounting information. The positive accounting theory is associated with comparability

and IAH, if financial accounting procedures use similar methods and numbers, comparability can be easily achieved.

## **2.3 Empirical Literature Review**

This sector of the study focuses on the previous studies that researchers have done based on the similar aspects of the research. It also avails thorough evidence on the functional components of the study and the standards of measurements of these components by other researches. It is divided based on the objectives of the study.

### **2.3.1 Effect of IFRS 9 on the profitability of the Listed Commercial Banks**

According to Ferrer & Ferrer, (2011) profitability ratios such as return on assets, return on equity, return on sales and earnings per share to explain and show the extent of financial disclosure and its relation to compliance of IFRS. They added that profitability is measured and regressed to the extent of financial reporting standard disclosure. Level of disclosure was measured using an index derived from the IFRS checklist. The researchers concluded that there is no significant relationship between the profitability checklist used the level of compliance of IFRS.

The researcher examined important differences between IFRS and GAAP using financial reporting ratios as matrices to determine the extent of effectiveness and efficiency. It was found that with IFRS, there is a higher balance sheet focus in terms of definition, disaggregation and discounting. There is also a high potential for higher revenues, higher depreciation and amortization expenses. There is also fewer development costs because of extraordinary items being prohibited and finally lower cost of goods sold, (Seay, 2014).

According to Latridis & Louvoris, (2010) found that despite harmonization of accounting information, higher quality of disclosure and enhanced comparability, adopting IFRS leads to lower cost of capital. Upon further research, it was observed that companies that Transition to IFRS showed lower profitability figures. However, as time progresses, companies show adjusted figures with higher profitability and growth. This could, therefore, mean that expenses incurred during the transition to IFRS may have been overcome leading to fewer costs and more income.

Miihkinen, (2010) states that the factors that contribute to the quality of a statement disclosure include firm size if the firm is listed on the NYSE and finally profitability of the organization. However, the impact on quality was observed more on less profitable firms. It was also observed that organizations give more information on risk associated with future performance and detailed solutions that will be used to deal with the forthcoming risk. Therefore with the implementation of IFRS risk disclosure improves leading to the enhanced quality of disclosures of the organizations.

### **2.3.2 Effect of IFRS 9 on the liquidity of the Listed Commercial Banks**

According to Lovin, (2013) liquidity of commercial banks improved after the adoption of IFRS. It was also observed that voluntary implementation bore more fruits compared to mandatory implementation in terms of liquidity. Investors showed more interest in companies that implemented the standards due to the high quality of reporting that was observed. With more interest from potential investors comes more money put in as capital from these investors as their investments in the organizations. The researcher also added that income volatility also increased after the implementation as financial institutions became fewer risk-takers. This was started by the methodology to recognize non-performing loans, the realization of expected and non-expected losses.

Cipullo & Vinciguerra, (2014) found that operations of banking institutions are related to the business model of the institution. This, therefore, means that the assets and liabilities are in relation to the future cash inflows and outflows. The assumption is that the carrying values reflect the business model strategy as well as the liquidity potential. The researcher found that instead of hooking the amortization and fair value of assets to the frequency of sales, they can sell the assets for the purpose of rebalancing their portfolio for cash flow purposes. According to IFRS 9, this will result in 'fair value through other comprehensive income classification for portfolios.

According to Tsai & Serin, (2018) the liquidity and risk profile of a company is connected to the accounting standards set. This is because the information released is in line with the accounting rules therefore the components of the liquidity and risk can be influenced by the accounting discipline. Future cash flows are determined by the recognition of assets. Therefore attention

should be given to the policies prescribed to the measurement and recognition of assets. The accounting standards should also influence the liability side. This, therefore, means that a company should have enough liquidity to meet obligations with immediacy.

Researches done indicate that earnings management has decreased over the years. It was also found that countries strong enforcement procedures have little earnings management. This because there are other factors that contribute to earnings management other than the IFRS standards. It was, therefore, said the IFRS standards would take time to have an impact. The argument that financial reporting is dependent on the country and its economic and financial environment still stands until institutional differences are phased out. Therefore institutional difference still influences financial reporting even after the adoption of IFRS standards. Therefore liquidity is also dependent on the financial incentives that institutions receive when it comes to reporting, (Cai, Rahman, & Courtenay, 2008)

### **2.3.3 The Benefits and Challenges of IFRS 9 Adoption**

According to AICPC (2019), about 120 countries and reporting jurisdictions allow IFRS and 90 countries use these accounting standards as required by the IASB with a statement of conformity in the audit reports. Some of the advantages of adopting the IFRS standards are, entities can represent the financial statements like those of foreign competitors, this automatically makes comparability easier. A disadvantage would be some people believe that GAAP is the best accounting standard and its quality will be lost with the acceptance and implementation of IFRS. Moreover, some entities may not see the need for using IFRS standards without any market incentive, where they do not have branches outside of the USA.

According to Danko (2016), some of the positive effects associated with the implementation of the standard include a rational representation for measurement and classification. Despite the extensive regulatory measures set out, other benefits include thorough credit assessment procedures. This is because most bad debts/loans are due to insufficient research on the creditors as well as the decline in the economic status or willful defaults. Some other benefits include close-knit tracking of assets. This is to ensure that the assets do not slip into the categories of 2 and 3 i.e underperforming or credit impaired.

Due to the slowed growth of the economy, economical interest rates and fierce competition, institutions are struggling with profitability levels. With the implementation of IFRS 9, there is a need to invest in certain resources such as IT and human resources. Due to the financial uncertainty that these firms are encountering as well as macroeconomic instability, financial institutions are focusing on momentary planning, making the implementation harder than it was anticipated to be. A benefit from the implementation of the standard would be the increase of legitimacy and indisputable models and information due to the enlarged scope which financial institutions are to impart their financial disclosures as per the impairment losses (ESRB, 2017)

Bendovschi (2016) stated that for emerging countries some benefits that arise from the adoption of IFRS standards include the improvement of comparability of the financial statements, growth in the degree of quality based on financial improvement, secure higher degrees of flexibility and increase in transparency. The transparency levels increase due to the implementation and usage of similar accounting principles that make comparison easier between local and international organizations. Some of the obstacles accompanied with the adoption include the absence of relevant knowledge and experience, the call for consulting and training services, obstacles faced in the use of the fair value phenomenon as well as the transition costs.

## **2.4 Research Gap**

Most of the studies referenced above are focused on either early adoption or projected views after the mandatory adoption date which was set on January 2018. Under the empirical literature review, studies have looked at the effects, benefits, challenges as well as the effect of corporate governance upon the adoption of the IFRS standards. The main goal of the study is to evaluate the financial performance of the listed banks and try to derive the meaning for understanding purposes. Aside from the financial purposes, the study will look at other factors that have been affected or affect the implementation process, for example, corporate governance.

Under the theoretical review, the theories stated above look at different aspects such as institutional theory as well as positive accounting theory. The study aimed to look at the different aspects stated in the theoretical and empirical review after the mandatory implementation in relation to the

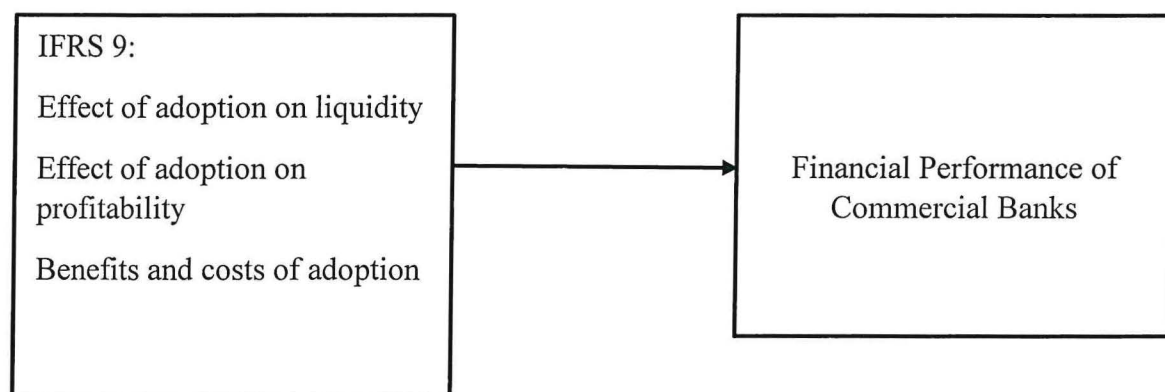
commercial banks. All commercial banks have now implemented IFRS 9. Few studies have been done after the first year of implementation to look at the factors stated above. Since most of the studies done are projections as well as studies on firms that voluntarily adopted the standards early, they do not have a wide basis for the study.

As this is the case, despite the short time frame after the compulsory implementation, the study will try to identify the change in financial performance, benefits experienced by the commercial banks as well as the costs or obstacles associated with the implementation of this standard and strive to relate it to the studies done by other researchers. To measure the impact of the implementation the study looked at the financial disclosures and relate it to areas the standard was bound to affect in financial accounting. The study also strived to relate the change in financial performance to the extent and effects of adoption, the role of corporate governance during adoption and the benefits and challenges encountered while implementing the standard.

## 2.5 Conceptual Framework

The conceptual framework is a substructure of intertwined concepts that avails a thorough understanding of an anomaly (Jabarene, 2009). It provides the intentions of the study. From the review of literature, the financial performance is affected by the independent variables such as the effect of adoption on liquidity, the effect of adoption on profitability and the challenges and benefits faced by the commercial banks. According to the theoretical review, agency theory and the positive accounting theory express the need for efficient accounting standards.

**Figure 2.1: Conceptual Framework**



Source: Researcher (2018)

## **2.6 Chapter Summary**

This chapter looked at previous researches done by various researchers on the impact of IFRS adoption particularly the IFRS 9 adoption. It presented theories that the study is based on as well as the concepts that the study strives to represent upon further research. The chapter focused on empirical researches based on the benefits as well as obstacles encountered in the adoption of IFRS standards as well as the relationship observed between the profitability and liquidity of the organizations after the adoption of the standard. The performance of companies is also focussed on. Under the theoretical review, agency theory is used to explain the need for IFRS adoption. PAT is used to explain the effect of various factors that determine the choice and implementation of accounting principles as the previous research studies have shown.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter deals with how the data was retrieved and scanned to show the overall extent IFRS 9 adoption and the impact it has to its financial performance as well as the benefits and obstacles experienced. It is split into four segments which are, research design, population, sample techniques, elements as well as data analysis which were used to achieve the named objectives of this study.

#### **3.2 Research Design**

This is a rundown of a simple procedure that includes all the possible measures to carry out the study. Cooper & Schindler (2013) state that descriptive research is applied to identify how the research will be done, where it is carried out and what it consists of. It avails a thorough picture of an individual, group and or situation. It is used to formulate an outline of the topic being focused on the data that has been retrieved. The qualitative and quantitative analysis was applied in the study to try and achieve the objectives stated before. The research design of this project was used to attain a quantitative analysis which established the effect of the IFRS adoption on the financial performance of the commercial banks.

#### **3.3 Population and Sample**

##### **3.3.1 Population**

Mugenda and Mugenda (2003) state that a population is a collection of individuals or objects with homogenous characteristics which are not difficult to identify. The focus of the investigation was to collect data from the commercial banks in Kenya ( about 40 commercial banks in Kenya). A target population is a group of components that have specific attributes that the researcher is seeking (Malhorta, 2007)

### **3.3.2 Sampling Technique**

In this study, the population was equal to the sample. Therefore, no sampling took place. There are only 11 commercial banks that are listed in the NSE out of the 43 commercial banks. Because of this, there was no impartiality associated with the collection of data. The sample size for the study was the eleven listed banks in Kenya.

### **3.3.3 Sampling Size**

Naresh & Birks (2007) refers to a sample as a combination of individuals or elements in a population that are chosen to partake in the study. It is the most suitable representation of the population being studied. The selection of the sample size must be done in a careful manner in order to show the attributes of the entire population (Bryman & Bell, 2015). The selected examinees for this specific study were the eleven listed commercial banks out of the 43 running commercial banks in Kenya.

### **3.4 Data collection methods**

The collection methods applied are primary and secondary data. The primary data was from questionnaires that were being sent out to the listed banks. On the other hand, secondary data was obtained from financial reports found on the bank websites as well as CBK's supervision reports and any related articles on the implementation of the IFRS 9. The financial statements that were studied were from the year 2013 to 2017 before implementation and 2018 which was the first year after implementation. The best-suited respondents for this specific study were people from the financial departments as well as those from the treasury and financial institutions departments.

According to Abawi (2013), a questionnaire is used to obtain information containing a series of questions that help the researcher to appropriate information. The data obtained should not contain questions that are inclined to manipulate the respondents as well as acquire exact and substantial information that is manipulated. The questionnaire included both open-ended and closed-ended questions. The closed-ended questions helped in formulating the scale while the open-ended questions assisted in gaining a better and expounded view of the close-ended questions. The

secondary information was attained from previous articles that are specific to the study that assisted in analysing and explaining the research focus.

### **3.5 Data Preparation**

#### **3.5.1 Data Editing**

This was done by the researcher after the questionnaires were filled out by the respondents and collected. It ensured the rectification of the questionnaires by the removal of any mistakes or incomplete responses given by the respondents so as to improve the accuracy, consistency of the obtained data (Kent, 2007).

#### **3.5.2 Data Analysis**

The study included both secondary and primary data. The primary data which was obtained from the questionnaires was cleaned and organized to be in line with the research objectives of the study. The primary data which was from qualitative data had closed and open-ended questions to the respondents. The secondary data were analyzed with the use of descriptive analysis. It also used correlation and regression analysis to determine the strength or relationship of two variables.

The regression model is in the below form;

$$Y = \alpha + \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Y = Financial Performance of commercial banks

$\alpha$  = Value of Y when other variables are zero

X<sub>1</sub> = Liquidity

X<sub>2</sub> = Profitability

E = Error Term

This regression model was used to illustrate the value of  $\alpha_0$  and  $\beta_i$  which shows the relationship between the independent and dependent variables. The reliability of the estimate of the beta was examined by the p-value in the ANOVA table. The data from the ANOVA table was examined by

the model and its acceptability from a statistical point of view. The adjusted R<sup>2</sup> was to show the extent of variance in the dependent variable that was shown by the independent variables to a maximum of 1. The F test was applicable in determining the significance of R which is similar to testing the significance of R<sup>2</sup> and the regression model as a whole.

### **3.6 Ethics in Research**

This section looks at the various requirements and guidelines to be followed while conducting the study. It will ensure that the research is of good quality and high standards. The various principles adopted to ensure its quality standards included the citation and referencing of studies done by other researchers to avoid any plagiarism. By doing this, respect for intellectual property was upheld and the integrity of the researcher was ensured. The objectives of the study also ensured that the researcher was not biased when conducting the research, therefore, practising honesty and transparency as no data was manufactured.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATION AND INTERPRETATION

#### 4.1 Introduction

This chapter examines the findings of the data collected and the relationship between the effect of the IFRS 9 adoption and its effect on the financial performance of the listed commercial banks. It has exhaustively included the research variables, descriptive analysis and regression analysis that were highlighted in the previous chapter. The data collected are from the disclosed financial statements from 2014 to 2018. There were also questionnaires that were sent out through online platforms such as Google forms and email from 4<sup>th</sup> October to 11<sup>th</sup> November. They were also sent out in physical form to other commercial banks. Out of the eleven questionnaires that were issued out to the commercial banks, 9 were filled making the response rate to be 81%.

**Table 4.1: Response Rate**

	<b>Total</b>	<b>Percentage</b>
<b>Responses Received</b>	9	81%
<b>Responses not Received</b>	2	19%
<b>Targeted Responses</b>	11	100%

Source: Primary Data (2019)

#### 4.2 Variables in the Study

There were two variables in the study; the independent variables and a dependent variable.

##### 4.2.1 Independent Variables

These variables included the profitability, liquidity, benefits and challenges experienced in the adoption of the standard. The profitability aspect was an aggregate amount of the profits made by the bank over the years. The liquidity as measured by the net assets the commercial banks reported over the years and the benefits and challenges were assessed through the questionnaires collected.

#### 4.2.2 Dependent Variable

This is the financial performance of the commercial banks that are measured by the comprehensive income.

#### 4.3 Descriptive Analysis

The years 2014-2017 will be grouped under pre-adoption of the standard and the year 2018 will be termed as post-production.

**Table 4.2: Secondary Research Findings**

<b>Year</b>	<b>Financial Performance of Commercial Banks (ksh.000)</b>	<b>Value of Net Assets (ksh.000)</b>	<b>Value of Profitability (ksh.000)</b>
<b>2014</b>	58,486,004	254,360,060	77,388,124
<b>2015</b>	62,596,773	362,229,382	60,191,499
<b>2016</b>	70,119,966	375,575,915	70,410,850
<b>2017</b>	81,083,193	365,755,402	76,272,925

<b>Mean</b>	68,071,484	339,480,190	71,065,850
<b>Max</b>	81,083,193	375,575,915	77,388,124

*Source: Research Findings (2019)*

**Table 4.3: Secondary Research Findings**

<b>Year</b>	<b>Financial Performance of Commercial Banks (ksh.000)</b>	<b>Value of Net Assets (ksh.000)</b>	<b>Value of Profitability (ksh.000)</b>
<b>2018</b>	84,358,516	443,520,478	83,956,975

*Source: Research Findings (2019)*

The comprehensive income was seen to have gradually increased over the years. The profitability dropped in 2015 from 2014. It proceeded to increase in 2016 and dropped in 2017. The cause of this could have been due to political reasons that naturally may have disturbed the business cycles over the year. In 2018 the profitability of the commercial banks was seen to have increased as the effects of the political events in 2017 are seen to have worn off. The net assets were seen to increase from 2014 to 2016. However, in 2017 they dropped by 26% to ksh.365 million. The net assets are seen to increase again in 2018.

#### **4.4 Correlation Analysis**

This type of analysis shows the relationship between the effect of IFRS 9 on financial performance based on liquidity and profitability.

**Table 4.4: Correlation Matrix**

	Y	X1	X2
Y	1		
X1	0.8055	1	

X2	0.5800	0.1654	1
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Source: *Research Findings (2019)*

In the correlation matrix, there is a strong positive correlation between liquidity and profitability of the commercial banks (0.8055) and (0.5800) respectively. This means that with an increase in profitability and liquidity there will be a resulting improvement in the financial performance of the commercial banks.

#### 4.5 Regression Analysis

The method assisted in estimating the dependent variable with the contribution of various independent variables.

**Table 4.5: Regression Model Pre-adoption**

Model	R	R Square	Adjusted R Square
1	0.9553	0.9126	0.7379

Source: *Research Findings (2019)*

**Table 4.6: Regression Model Post-adoption**

Model	R	R Square	Adjusted R Square
1	0.9242	0.8542	0.7084

Source: *Research Findings (2019)*

In the pre-adoption table, the adjusted R Square indicates that about 74% of the variance in the financial performance of the banks is partly because of the liquidity and profitability of the banks. The remainder which is 26% of the variability of the financial performance is attributable to other factors that are not covered in this research study. However, in the post-adoption table, the adjusted R Square accounts for 70% variance in the financial performance that is attributable to the liquidity and profitability. The R is the correlation coefficient which shows the strength of the relationship between the variables. This also shows that there is a strong positive relationship between the

financial performance with liquidity and profitability of 0.9242 after the adoption, but was higher at 0.9553 before the adoption of the standard.

**Table 4.7: Anova Pre-adoption**

Model	Sum of Squares	DF	Mean Square	F.	Significance F
Regression	2.7140	2	1.3514	5.2232	0.2955
Residual	2.5813	1	2.5813		
Total	2.9514	3			

*Source: Research Findings (2019)*

**Table 4.8: Anova Post-adoption**

Model	Sum of Squares	DF	Mean Square	F.	Significance F
Regression	4.3357	2	2.1714	5.8592	0.1458
Residual	7.3997	2	3.7130		
Total	5.0757	4			

*Source: Research Findings (2019)*

The above table shows the significance of the regression estimation model. It shows that the model is important in illustrating the relationship between financial performance which is represented by the comprehensive income and the liquidity and profitability at 0.2955 before adoption and changed to 0.1458 after adoption. This is a clear indication of the weak relationship before adoption which although improved after the adoption of IFRS 9, still showed a weak relationship between the effect of IFRS 9 on commercial bank performance with the liquidity and profitability. This also indicates that the IFRS 9 had little effect on the independent variables and ultimately the dependent variables.

**Table 4.9: Coefficients Pre-adoption**

Model	Beta	Standard Error	T	P-Value
Constant	-6.607	44300879	-1.49927	0.374478
Liquidity	0.183498	0.059361	3.091227	0.19918
Profitability	1.015907	0.43019	2.36153	0.255005

*Source: Research Findings (2019)*

The regression model is derived from the table above and therefore becomes;

$$Y = -6.607 + 0.183498 (\text{Liq}) + 1.015907 (\text{Pft})$$

**Table 4.10: Coefficients, Post-adoption**

Model	Beta	Standard Error	T	P-Value
Constant	-15008670.14	28018749.74	-0.53567	0.645785
Liquidity	0.121121198	0.045448338	2.66503	0.116667
Profitability	0.579802469	0.345473545	1.678283	0.235296

*Source: Research Findings (2019)*

The regression model is derived from the table above and therefore becomes;

$$Y = -15008670.14 + 0.121121198 (\text{Liq}) + 0.579802469 (\text{Pft})$$

#### 4.6 Discussion of Findings

The results from the secondary data are shown in the tables above and they indicate the effect of IFRS 9 on the financial performance (comprehensive income) of commercial banks which again are based on liquidity (net assets) and profitability before and after adoption. The financial performance of the banks was seen to gradually improve especially in 2016 when it increased by 13%. The negative value of Y when the variables are 0, which is represented by  $\alpha$  does not mean anything, it simply where the regression line falls on the Y-axis and can, therefore, be negative or positive. This also means that profitability and liquidity also gradually improved in the five-year course.

The regression analysis results illustrate that R which is 0.9242 implies that the goodness-of-fit is good after adoption before adoption it was 0.9553. Therefore, this means that the collective effect of the independent variables to the dependent variable is about 96% before adoption and 92% after adoption of the standard. The R Square before the adoption is 91.26% and 85.42% after adoption which indicates that the changes in the independent variable can be well used to explain the variations in the dependent variable. In 2018 the net assets of the commercial banks went up by 78 million which is a great improvement compared to the other years. This could be attributed to the

IFRS 9 model used for the initial recognition of financial assets and liabilities. The profitability of the commercial banks as well increased by 9% in 2018 which is the second-highest improvement from 2015. The two aspects definitely contribute to the financial performance however there was no significant change in the liquidity or profitability that could be considered crucial as of now.

#### 4.7 Demographic Data

This section illustrates information on the last objective of the research study which is the benefits and challenges encountered during the implementation of the standard. The data retrieved was based on years of existence, the tier group of the commercial banks as well as the year of adoption of the standard. The questionnaire was filled by mostly accountants from the commercial bank or the people who have come across the standard in their workings.

**Table 4.11: Years of Existence**

<b>Year</b>	<b>Frequency</b>	<b>Percentage</b>
< 5 years	-	0%
5 – 10 years	-	0%
10 – 20 years	1	11%
> 20 years	8	89%
<b>Total</b>	<b>9</b>	<b>100%</b>

*Source: Research Findings (2019)*

Majority of the commercial banks that responded were established over 20 years ago, only one was formed 10 to 20 years ago. This indicates their establishment and is mostly well equipped to face any challenges associated with the implementation leaving a very little effect.

**Table 4.12: Tier Group**

<b>Tier</b>	<b>Frequency</b>	<b>Percentage</b>
1	9	100%
2	-	0%
3	-	0%
<b>Total</b>	<b>9</b>	<b>100%</b>

*Source: Research Findings (2019)*

In this category, all the banks are tier one banks indicating that their capital is the main source funding. The capital contains shareholders' equity as well as the retained earnings.

**Table 4.13: Year of Adoption**

<b>Adoption Year</b>	<b>Frequency</b>	<b>Percentage</b>
5 years ago	1	11%
<5 years ago	1	11%
2018	7	78%
<b>Total</b>	<b>9</b>	<b>100%</b>

*Source: Research Findings (2019)*

The above findings show that most of the listed commercial banks adopted IFRS 9 in 2018, specifically January 1<sup>st</sup> which was the compulsory date of adoption for the standard for all financial entities. There are the two commercial banks that adopted it before which gave them more time to familiarize with the standard.

#### 4.8 Benefits of Implementing IFRS 9

**Table 4.14: Benefits of Implementation**

	<b>Transparency has increased in the financial statements</b>	<b>Investor confidence has increased in the financial statements</b>	<b>The cost of equity capital has been lowered in the financial statements</b>	<b>Financial statements are easier to audit</b>	<b>Better information is provided for decision-making</b>
Strongly Disagree	0.0%	0.0%	0.0%	0.0%	0.0%
Disagree	0.0%	0.0%	33.0%	23.0%	0.0%
Moderate	0.0%	0.0%	44.0%	33.0%	0.0%
Agree	56.0%	56.0%	33.0%	0.0%	56.0%
Strongly Agree	44.0%	44.0%	0.0%	44.0%	44.0%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Source: Research Findings (2019)*

The third objective of the study was to determine the benefits and challenges of adopting the standard. The question was based on the convenience and ease the standard impacted on the entities. Most of the respondents mentioned that the adoption of the new standard was either at an advanced level or at 100% adoption. Some respondents mentioned that it allows timely consideration on the application of economic factors affecting portfolio performance. Other respondents mentioned that the standard was easy to adopt. This could be attributed to the guidance of the Central Bank of Kenya that had outlined guidelines for the adoption of the standard.

100% of the respondents had indicated that transparency increased with the adoption of the standards especially in the recognition of assets and liabilities which can ultimately affect the company liquidity. This is also the same for investor confidence as disclosures are more accurate and the standard encourages comparability between entities. Also, 100% of respondents seemed to have agreed on the availability of better information for decision making because the standard has increased the quality of information. However, the view that the cost of equity has not been minimized with the adoption of the standard split between the respondents.

#### 4.9 Challenges of Implementing IFRS 9

**Table 4.15: Challenges of Implementation**

	The standard is too complicated to understand	Lack of requisite skills and knowledge on IFRS	A lot of money incurred in training the accounting staff	Preparation of financial statements using IFRS 9 is complicated	Professional training is not enough
Strongly Disagree	22.0%	11.0%	10.0%	11.0%	11.0%
Disagree	34.0%	22.0%	0.0%	11.0%	22.0%
Moderate	22.0%	11.0%	34.0%	78.0%	11.0%
Agree	22.0%	56.0%	56.0%	0.0%	34.0%
Strongly Agree	0.0%	0.0%	0.0%	0.0%	22.0%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Source: Research Findings (2019)*

According to the respondents, some of the costs incurred included training costs, model creation costs, staffing costs and system enhancement costs during the implementation of the standard. The respondents also mentioned that the standard was not easily manipulated to produce more desired results. Others stated the opposite adding that the inputs to the model such a probability of default,

loss given default and post-write-off recoveries could be manipulated. The respondents also added that the standard is based on management assumptions which are subjective. It was also mentioned that the standard had also increased the work placed on the accountants and those that came across it. This was due to the additional reporting and development of new models. 56% of the respondents found the standard not too complicated to understand while others did seem to find it hard to understand it. 56% of the respondents also found that there was a lack of proper skills and knowledge on IFRS and the cost incurred on training the staff was high. The respondents were not too sure on the difficulty of preparation of the statements using the standard were 78%.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Summary

The purpose of the study was to determine the effect of IFRS 9 on financial performance. However, this chapter is a summary of the key findings of the project in relation to the three objectives of the study. The chapter will also contain conclusions based on the findings and suggested recommendations.

The research project focussed on achieving three objectives which were; to determine the effect of IFRS 9 on the profitability of commercial banks, to determine the effect to IFRS 9 on the liquidity of commercial banks and to determine the benefits and challenges of implementing the standard.

#### 5.2 Summary of the Findings

This section represents the summary of the key findings of the research that are in relation to the three objectives.

##### 5.2.1 Effect of IFRS 9 on the liquidity of Listed Commercial Banks

Secondary data was used to derive results for this objective. The data collected from the financial statements of the listed commercial banks were used to formulate a correlation and regression analysis together with the second objective to evaluate the change in financial performance. The correlation analysis was used to evaluate the strength of the relationship between the financial performance and liquidity of the commercial banks. The correlation coefficient on liquidity was 0.8055.

Leung and Clinch (2014) also agreed to the fact that with the IFRS adoption, liquidity in both public and private firms has increased. This is could be due to the liquidity model that IFRS 9 has introduced. Though accountants face more work on creation and understanding of the models. The

correlation stated in the correlation matrix is 0.8055 clearly shows that the financial performance is highly dependent on financial performance for the listed commercial banks. The increase in liquidity for the year 2018 can be attributed to the recognition guidelines of financial assets in the standard.

### **5.2.2 Effect of IFRS 9 on the Profitability of Listed Commercial Banks**

Secondary data was also used to formulate the results needed to satisfy this objective. A correlational and regression analysis was done in combination with liquidity which has been explained in the previous section. The correlation coefficient of profitability shown in the correlation matrix is 0.5800. Though the relationship is not as strong as liquidity, the relationship between financial performance and profitability is moderately strong and positive. This could be because financial performance is based on other factors shown in the balance sheet and cash flow statement.

Firoz, Ansari, and Akhtar (2011) added that the standard has an effect on profitability due to the guidelines on efficient provisions for loss, the thorough credit risk management and financial evaluations that lead to fewer losses and ultimately higher profits. With the effect of IFRS 9 on the profitability of listed commercial banks, the effect is also translated to financial performance. With the implementation of the standard, the financial institutions are able to assess and prepare for any economic changes in order to reduce any adverse effects such as high losses. The financial crisis is a major reason for the formulation of the standard. The increase in the profitability of the commercial banks can also be attributed to the standards' effects

### **5.2.3 Benefits and Challenges of IFRS 9 adoption**

This objective required primary data to derive information on it. The questionnaire which is attached in the appendix section focused on the benefits and challenges encountered by the commercial banks while implementing the standard. Most of the commercial banks implemented the standard on the compulsory date of January 1<sup>st</sup> 2018. As expected challenges were encountered even though the goal was to minimize any adverse effects the economic state would have on the

stability of the commercial banks. The benefits that the respondents agreed to were increased transparency, increased investor confidence and provision of better information for decision-making. Many did not have much to say on the flexibility of the standard

Challenges that were experienced in the adoption of the standard include high costs for training, lack of professional training and complications experienced in the preparation of the financial statements. The costs attributable to the standard were training costs which included budgets spent on training the staff on how to prepare statements that were inline with the standard as well training in the development of models that followed the requirements of the standard. Other costs included hiring staff that were up-to-date on the standard and knew it perfectly well to complement the rest of the staff who were not too familiar with the standard. System enhancement and model development costs were also included. This was to update their systems with the procedures and requirements of the new standard as well as formulate models that followed the guidelines of the standard.

### **5.3 Conclusions.**

In light of the findings above, the following conclusions can be made:

According to Sanghani (2013), there is a positive and strong effect on the financial performance and liquidity of listed companies in the NSE. This means that liquidity affects financial performance in a positive manner. Since IFRS 9 touches on the initial recognition and derecognition of financial assets and liabilities it is bound to also affect the financial performance shown in financial disclosures. IFRS 9 affects liquidity in a positive manner due to the guidelines that are more accurate and efficient. This can also reflect on the return on assets as well as working capital needed for business operations

Ntaikou & Vousinas (2019) conclude that with the implementation of IFRS 9, losses are avoided leading to greater financial stability and ultimately higher profits. With the implementation of the standard, the financial institutions are able to asses and prepare for any economic changes in order to reduce any adverse effects such as high losses. The financial crisis is a major reason for the formulation of the standard. The commercial banks will be able to formulate models and

contingency plans that will protect them from any economical downfalls and minimize the effects of such.

Firoz, Ansari, and Akhtar (2011) added that the standard was a little flexible in terms of classification of assets which is dependent on initial recognition and amortized costs. It was also found that the standard could be easily manipulated through the inputs to the model as it is also based on management assumptions which are deemed subjective. Another challenge to the accountants included an increase in work-load which meant that all accountants need sufficient support to justify the assumptions made so as increase objectivity as well formulation of the IFRS 9 models.

#### **5.4 Recommendations**

Firstly, from the findings of the research study, the listed commercial banks should look at the standard as a mandatory unnecessary procedure to follow but as a step towards financial stability and superior quality in financial disclosures. This is because all financial institutions will report their financial information in a more standardized and uniform manner. This will ultimately lead to higher comparability and attract more investors which will lead to a deeper pool of capital.

Moreover, it is advisable for the commercial banks that have not implemented the standard to an advanced level or fully to do so as the Kenyan economy is known to backtrack during major political events such as the general elections. Seeing as this is the norm, the accountants and financial analysts with the help of IFRS 9 will be able to foresee the effects of such occurrences and prepare adequately by making sure they will have adequate working capital for those periods. They can also apply protective measures such as management of domestic currency debts, better banking supervision and better disclosure. IFRS 9 can assist as it also based on hedging, recognition and derecognition of financial assets and liabilities as well as capital requirements.

Lastly, the costs associated with the implementation can be minimized. Instead of training staff and hiring more staff to handle the transition to IFRS 9, the commercial banks can hire a

specialized team to create the models. It is quite difficult for banks to outsource financial models as they are highly sensitive and should remain in close contact with the executives due to the information withheld in them. The specialized team can be hired strictly for the creation and maintenance of the model that follows the standard's regulations. For the sake of reduction of implementation costs and superior work, this would be the best approach.

### **5.5 Limitations of the Study**

This study avails fundamental information on the implementation of IFRS 9 and its effects on the profitability and liquidity of an entity as well as its financial performance. The study also looks at the benefits and challenges associated with the implementation of the standard. The study focusses on the listed commercial banks in Kenya. However, the standard has only been implemented by all the financial institutions as of 1<sup>st</sup> January 2018. It is therefore based on findings of one year after the implementation. This may not be an exhaustive research study as the implementation for some has not been in full effect. It could, therefore, be too early to conclude on the effect of the standard on financial performance.

Out of the 31 banks that exist in Kenya, only 11 have been picked out which are the listed commercial banks of Kenya. There are several banks that are either in acquisition or are being merged with other banks. The effect of IFRS 9 in such conditions has also not been looked at. However, Louis & Urcan (2014) suggested that the mandatory adoption of IFRS did not contribute to the increase in acquisitions. This could also be applicable to IFRS 9. Financial Institutions, mainly banks can be considered an integral part of the financial economy of a country. Therefore, it is probable that the analysis of all the banking institutions would have given more conclusive results.

### **5.6 Suggestions for further research**

With regards to the limitations of this research that have been listed above, future researchers should work on the following:

First, a similar study should be done but after a few years, for example, two to three years later. This is because the researcher will be able to get more conclusive results and can compare three years before adoption and three years after adoption. This will avail better findings that are more relatable to the topic of this study.

Secondly, the future researcher should study all the commercial banks in Kenya rather than just the listed banks to attain more conclusive results. The study will contain results from foreign banks that have just come to the country as well as the commercial banks that have just undergone mergers and acquisitions. The effects of fundamental events in the country after the mandatory implementation will also be shown.

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## APPENDICES

### APPENDIX 1: LETTER OF INTRODUCTION

Dear Sir/Madam

**RE: REQUEST FOR RESPONSE TO QUESTIONNAIRE**

I am a Bachelor of Commerce student at Strathmore University, Nairobi. In partial fulfilment of the undergraduate degree, I am required to conduct a research project. With regards to this, I am carrying out a survey on “The effect of IFRS 9 on the financial performance of the listed commercial banks in Kenya.”. The questionnaire, however, focusses on the benefits and challenges experienced while implementing the standard.

I therefore kindly request you to spare a few minutes of your time to answer this questionnaire. I also request you to provide an honest response to all the questions contained in this questionnaire. All the information that you will provide, will be treated with the utmost confidentiality and will be used solely for academic purposes.

Thank You.

Yours Faithfully,

Georgina Mbaire Karanu

Strathmore University

## APPENDIX 2: QUESTIONNAIRE

Please supply the required data by filling in the blanks where space is provided or by ticking [✓] against the most appropriate answer.

### SECTION A: GENERAL INFORMATION

1. How long has the company been in existence?
  - a) Less than 5 years
  - b) 5 to 10 years
  - c) 10 to 20 years
  - d) More than 20 years
2. The size of the bank in terms of capital.
  - a) Tier 1
  - b) Tier 2
  - c) Tier 3
3. When did you adopt IFRS 9
  - a) 5 years ago
  - b) Less than 5 years ago
  - c) 2018

### SECTION B: BENEFITS OF ADOPTING IFRS 9

Kindly fill in where necessary

	Strongly Disagree	Disagree	Moderate	Agree	Strongly Agree
Transparency has increased in the financial statements					
Investor confidence has increased in the financial statements					

The cost of equity capital has been lowered in the financial statements					
Financial statements are easier to audit					
Better information is provided for decision-making					

a) What is the extent of adaptation of the new standard?

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b) What is your opinion in the increase in flexibility upon the usage of the new standard?

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c) Has it increased? \_\_\_\_\_

d) If not why?

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### SECTION C: CHALLENGES OF IMPLEMENTING IFRS 9

Kindly fill the table where necessary.

	Strongly Disagree	Disagree	Moderate	Agree	Strongly Agree
The standard is too complicated to understand					
Lack of requisite skills and knowledge on IFRS					
A lot of money incurred in training the accounting staff					

Preparation of financial statements using IFRS 9 is complicated					
Professional training is not enough					

a) Kindly list the costs incurred in implementation of the new standard

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b) Can the standard be easily manipulated allowing the commercial banks to show only the results they desire?

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c) If yes, what can be manipulated to show desired results?

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d) Has it also increased the work placed on accountants and if so, to what extent?

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**APPENDIX 3: LISTED COMMERCIAL BANKS IN KENYA AS OF 2019**

	<b>BANK</b>
1	Barclays Bank Ltd
2	I & M Holdings Ltd
3	Diamond Trust Bank Kenya Ltd
4	HF Group Ltd
5	KCB Group Ltd
6	National Bank of Kenya Ltd
7	NIC Bank Ltd
8	Standard Chartered Bank Ltd
9	Equity Group Holdings
10	CFC Stanbic Holdings Ltd
11	Co-operative Bank Ltd

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<p>&lt; 1% match (student papers from 21-Aug-2014)  Submitted to University of Edinburgh on 2014-08-21</p>
<p>&lt; 1% match (student papers from 17-Jul-2011)  Submitted to Strathmore University on 2011-07-17</p>
<p>&lt; 1% match (Internet from 27-Jul-2019)  <a href="https://pdfs.semanticscholar.org/d8df/ba2e4e17f696f92762891386eed16ed88cf2.pdf">https://pdfs.semanticscholar.org/d8df/ba2e4e17f696f92762891386eed16ed88cf2.pdf</a></p>
<p>&lt; 1% match (Internet from 13-Nov-2019)  <a href="https://pdfs.semanticscholar.org/7fad/7b671f455f200fd24e0d276ec44a05efc5eb.pdf">https://pdfs.semanticscholar.org/7fad/7b671f455f200fd24e0d276ec44a05efc5eb.pdf</a></p>
<p>&lt; 1% match (Internet from 03-Dec-2019)  <a href="https://id.123dok.com/document/q7llljdy-bab-iii-metoda-penelitian-a-jenis-penelitian-analisis-pengaruh-intellectual-capital-profit-sharing-ratio-zakat-performance-ratio-debt-to-equity-ratio-terhadap-kinerja-keuangan-bank-umum-syariah-di-indonesia-2012-201-repository-perpustakaan.html">https://id.123dok.com/document/q7llljdy-bab-iii-metoda-penelitian-a-jenis-penelitian-analisis-pengaruh-intellectual-capital-profit-sharing-ratio-zakat-performance-ratio-debt-to-equity-ratio-terhadap-kinerja-keuangan-bank-umum-syariah-di-indonesia-2012-201-repository-perpustakaan.html</a></p>

<p>&lt; 1% match (student papers from 12-Feb-2018)  <u>Submitted to Kenyatta University on 2018-02-12</u></p>
<p>&lt; 1% match (student papers from 22-May-2015)  <u>Submitted to Kenyatta University on 2015-05-22</u></p>
<p>&lt; 1% match (student papers from 23-Sep-2014)  <u>Submitted to Coventry University on 2014-09-23</u></p>
<p>&lt; 1% match (student papers from 13-May-2013)  <u>Submitted to Leeds Metropolitan University on 2013-05-13</u></p>
<p>&lt; 1% match (student papers from 30-Oct-2015)  <u>Submitted to South Bank University on 2015-10-30</u></p>
<p>&lt; 1% match (Internet from 26-Sep-2019)  <a href="https://eap.uonbi.ac.ke/sites/default/files/cees/education/eap/FAITH2.pdf">https://eap.uonbi.ac.ke/sites/default/files/cees/education/eap/FAITH2.pdf</a></p>
<p>&lt; 1% match (Internet from 07-Sep-2019)  <a href="http://www.sweat.org.za/wp-content/uploads/2016/02/Actions-of-Female-Sex-Workers-Thesis-1.pdf">http://www.sweat.org.za/wp-content/uploads/2016/02/Actions-of-Female-Sex-Workers-Thesis-1.pdf</a></p>
<p>&lt; 1% match (student papers from 08-Nov-2016)  <u>Submitted to Kenyatta University on 2016-11-08</u></p>
<p>&lt; 1% match (student papers from 10-May-2018)  <u>Submitted to Mount Kenya University on 2018-05-10</u></p>
<p>&lt; 1% match (student papers from 16-May-2019)  <u>Submitted to Top Education Institute on 2019-05-16</u></p>
<p>&lt; 1% match (Internet from 18-Aug-2019)  <a href="https://pdfs.semanticscholar.org/bd64/9a7010b9b4dd1ce470e13975283ccf31858c.pdf">https://pdfs.semanticscholar.org/bd64/9a7010b9b4dd1ce470e13975283ccf31858c.pdf</a></p>
<p>&lt; 1% match ()  <a href="http://eprints.nottingham.ac.uk/10847/1/Full_thesis_pdf_copy.pdf">http://eprints.nottingham.ac.uk/10847/1/Full_thesis_pdf_copy.pdf</a></p>
<p>&lt; 1% match (Internet from 07-Aug-2019)  <a href="https://sanurfransiskus.wordpress.com/author/sanurfransiskus/">https://sanurfransiskus.wordpress.com/author/sanurfransiskus/</a></p>
<p>&lt; 1% match (student papers from 21-Sep-2017)  <u>Submitted to Kenyatta University on 2017-09-21</u></p>
<p>&lt; 1% match (student papers from 25-Jul-2016)  <u>Submitted to Kenyatta University on 2016-07-25</u></p>
<p>&lt; 1% match (student papers from 22-Nov-2019)  <u>Submitted to Radboud Universiteit Nijmegen on 2019-11-22</u></p>
<p>&lt; 1% match (student papers from 02-Jul-2014)  <u>Submitted to Universiti Teknologi MARA on 2014-07-02</u></p>
<p>&lt; 1% match (student papers from 28-Nov-2018)  <u>Submitted to South Bank University on 2018-11-28</u></p>
<p>&lt; 1% match (Internet from 18-Jul-2019)  <a href="https://docplayer.net/20013972-An-empirical-study-of-e-banking-in-cameroon.html">https://docplayer.net/20013972-An-empirical-study-of-e-banking-in-cameroon.html</a></p>
<p>&lt; 1% match (Internet from 22-Feb-2015)  <a href="http://www.garakuta-boeki.com/shibuya/?month=201001">http://www.garakuta-boeki.com/shibuya/?month=201001</a></p>
<p>&lt; 1% match (student papers from 02-Oct-2014)  <u>Submitted to Kenya College of Accountancy University on 2014-10-02</u></p>
<p>&lt; 1% match (student papers from 11-Dec-2018)  <u>Submitted to Strathmore University on 2018-12-11</u></p>
<p>&lt; 1% match (student papers from 15-Feb-2016)  <u>Submitted to Kenyatta University on 2016-02-15</u></p>
<p>&lt; 1% match (student papers from 13-Sep-2019)  <u>Submitted to University of Bedfordshire on 2019-09-13</u></p>
<p>&lt; 1% match (student papers from 15-Sep-2016)  <u>Submitted to Cardiff University on 2016-09-15</u></p>
<p>&lt; 1% match (student papers from 23-Nov-2017)  <u>Submitted to Strathmore University on 2017-11-23</u></p>
<p>&lt; 1% match (student papers from 06-Nov-2018)  <u>Submitted to University of Wales central institutions on 2018-11-06</u></p>
<p>&lt; 1% match (student papers from 03-Mar-2016)  <u>Submitted to Leeds Beckett University on 2016-03-03</u></p>

<p>&lt; 1% match (student papers from 24-Mar-2016) <u>Submitted to EDMC on 2016-03-24</u></p>
<p>&lt; 1% match (publications) <u>"FINANCIAL INSTRUMENTS", Wiley, 2019</u></p>
<p>&lt; 1% match (student papers from 07-Nov-2019) <u>Submitted to Somerset College on 2019-11-07</u></p>
<p>&lt; 1% match (student papers from 08-Nov-2017) <u>Submitted to University of Edinburgh on 2017-11-08</u></p>
<p>&lt; 1% match (student papers from 26-Oct-2018) <u>Submitted to Kisii University on 2018-10-26</u></p>
<p>&lt; 1% match (student papers from 08-May-2015) <u>Submitted to Higher Education Commission Pakistan on 2015-05-08</u></p>
<p>&lt; 1% match (student papers from 24-Aug-2012) <u>Submitted to Laureate Higher Education Group on 2012-08-24</u></p>
<p>&lt; 1% match (student papers from 26-Oct-2017) <u>Submitted to University of the Western Cape on 2017-10-26</u></p>
<p>&lt; 1% match (student papers from 23-Feb-2014) <u>Submitted to EDMC on 2014-02-23</u></p>