

**MOTIVATION FACTORS FOR EARNING MANAGEMENT PRACTICE IN
KENYAN FIRMS: CASE FOR PUBLIC LISTED CORPORATIONS.**

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ABSTRACT

The purpose of this study was to examine the extent to which earning management was practiced in Kenyan public listed corporations, Specifically to establish the motivation behind the practice of earnings management in public listed corporation in Kenya, establish the extent to which earnings management is practiced in the corporations, and also establish the relationship between incentives structures and the practice of earnings management in those corporations.

The Agency and the stakeholder theories guided the study, exploratory research design was adopted. The study population included all the 56 public listed corporations. Simple random sampling method was used to get 33 public listed corporations as the representative sample. Questionnaire tools were used to collect the required information and the return rate was 100%. The respondents were staff who worked in the finance department.

It was established that the factors more likely to be responsible for earnings management in public listed corporations in Kenya are; High shareholders' expectations in terms of high profitability from management; Poor financial performance of a company that negatively affects its reputation in the public; and Management incentives based on company performance induces managers to mis-report financial performance. The factors that require further investigations include; Purposeful possession of the company shares by management with intent to sell them to increase their wealth, Weak internal controls systems of the company, Management subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures; and High external auditor turnover.

The relationship between the factors influencing earning management practice in Kenyan firms' was established. However the coefficient of determinant (R^2) was 0.31 suggesting a weak relationship between the dependent and the independent variables suggesting that there are other variables responsible for variations in earnings management other than those identified by this study.

other ways listed companies could achieve earnings management in public listed companies include; Expectations of shareholders based on industry performance, Pressure for management to show good results, poor accounting systems, that are difficult to understand thereby giving room to alterations, to avoid the issue of profit warning, to prevent theft of company resources

from being detected, to avoid payment of heavy taxes, to avoid alienating current investors and new investors, to avoid pressure to yield to workers asking for higher wages, to ensure company sustainability, Lack of qualified senior lever team, Motivation of company staff with good results , to increase goodwill of shares performing poorly in the stock exchange, to safeguard management reputation through financial performnce, to meet the statutory requirements , to safeguard the Tenure of the head of finance , Poor application of international reporting standards, and Related party transactions.

The study recommended regulation guiding share ownership by management and employees of respective firms is instituted by the regulating authorities. Further research was recommended on the other additional factors responsible for the earnings management practice since the regression model developed out of the factors identified by this study only accounted for 31 percent of the variations.

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CHAPTER ONE

INTRODUCTION

1.1 Study Background

Earning management has been practiced in the last few decades. It takes place when managers use self or organisation judgment in financial reporting and in designing transactions to alter financial reporting either to misguide some stakeholders about the underlying economic performance of the company or to have undue influence on contractual outcomes that depend on reporting accounting numbers (Healy and Wahlen, 1999). Stolowy and Breton (2004), refer to earning management as “manipulation of accounts. They describe it as the use of management’s discretion to decide on accounting choices or to design transactions in a way that it will affect the chances of wealth transfer between the company and society, fund providers or managers. This manipulation of accounts leads into creative accounting, earning management and fraud.

Davidson et al. (1987), cited in Schipper (1989), define earnings management as the process of making intentional steps within the limitation of generally accepted accounting principles to bring about a needed level of reported income. Fischer and Rosenzweig (1995) define earnings management as manager’s action which increase/decrease current reported earnings of a company financials with no corresponding increase/decrease in the long-term economic gain in the company; this is the definition that will be used throughout the study.

The practice of earnings management is related to an objective of manipulating income. To meet earnings management objectives, managers’ use accounting decisions such as depreciations or provisions or decisions related to real activities, such as production, sales, financing or investment. In a context of information asymmetry, earnings management can be viewed as a signal send to the users of financial report information. For example, according to Trueman and Titman (1988), firms smooth earnings to influence stakeholders’ behaviors and modify their perception of firms’ earnings variability.

Jooste, (2011) argues that there is positive and negative side to earning management. The negative side is the misallocation of resources which is cost created which this study will address and the positive side is the potential in the development of management’s credible communication of private information to external stakeholders to improve resources allocation decisions.

According to Hand (1990), earnings management is an opportunistic practice. This approach is based on the functional addiction hypothesis, which reflects that users of financial information are not able to correctly interpret and understand accounting numbers and accounting choices. In that case, earnings management can be seen as a way to mislead investors and other users of accounting figures, about the performance of the firm. Most researches adopt the opportunistic approach of earnings management.

Managers have financial incentives when they meet their performance expectation of security analysis of investors, creditors, etc. Financial incentives have created pressure on corporate management to meet earnings target lack of meeting these targets have resulted in significant drop in the stock price of the firm, and thus reduction in manager's compensation since their reward may rely mostly on achieving earnings or stock price targets (Tina et al., 2005).

Studies have shown that earnings projections and insistent management attitudes towards financial reporting were among the primary managerial motivation for fraudulent financial reporting (Albrecht and Romney, 1986). Prior literatures discuss the relation between corporate governance and earning management (Ruth and Toriq, 2009; Albrecht et al., 2004; Hatice et al., 2004). Other existing prior studies are about reporting disclosures, voluntary disclosures and risks, compliance of International Financial Reporting Standards (IFRS) (Omama et al., 2011; Pran, 2012; Ghassan, 2012; Tyrone and Nigel, 2010). This empirical study analyzes how and what causes the management to practice earning management.

According to the Companies Act chapter 486 of the laws of Kenya a public corporation is company that has a minimum number of seven members. Most of the public companies start as private companies then they convert to public companies when they invite members of the public to subscribe to their shares and debentures. The Companies Act requires that when the membership of a private company exceeds fifty, then it must convert to a public company. Public companies are rarely used except in the case of companies listed on the Nairobi Stock and Security Exchange and for reasons related to the control of dealings in agricultural land. Even then, it is usual to incorporate as a private company and convert subsequently.

The line that separates earning management and management fraud is too thin and managers are becoming reluctant to discuss the linking of these two concepts (Brown, 1999). This study will be for public listed companies in Kenya. Corporate scandals and fraudulent reporting of financial statements has become a matter of concern in both social and economic aspect. News abound with corporate fraud scandals (Kathleen et al., 2004). Information available

from the Capital Markets Authority (CMA) indicate that companies affected by this practice in the recent past in Kenya include CMC Motors, Nyaga Stock Brokers, and Uchumi supermarkets among others while in the United States casualties include Enron, World com, and Tyco among others (Kathleen et al., 2004).

The cost of accounting scandals is huge since it leads to reduction of firm value, reduced investors confidence, bankrupt firms, increased unemployment and additional regulation (Robert, 2011). These practices have led to public cry and dissatisfaction (Kathleen et al., 2004). Many legislative and regulatory changes have come up due to frauds. The occurrence has made legislators, regulators, practitioners and academics to search for answers of the causes of the alleged frauds. Knowing the forces that have given rise to the frauds is an important step to efficiently preventing and reducing future occurrences (Tina et al., 2005).

Fraudulent reporting was first exposed after the United State of America great economic crash in 1929, then after Savings & Loans financial scandals in the 1980s and soon after the dot-com bubble from early 1990s to 2000s (Robert, 2011). The rising pressure to reduce fraudulent financial reporting over the years has resulted in new laws, commission reports and standards. Congressional inquest into the savings and loan debacle in the commission whose mandate and duty was to lay down effective recommendation to steer the Auditing Standards Board (ASB) development of standards to assist in preventing and detecting fraud. The National Commission on Fraudulent Financial Reporting was created in the United States in 1987 to better illustrate auditors responsibilities in preventing and detecting fraud.

The auditing professional organizations, the American Institute of CPA's, the institute of internal auditors and the National Association of Accountants with many others stakeholders founded the commission to endorse on study and make recommendations (Huntom et al., 2006).

As it has been observed in the recent times as from 1990s, the increase in performance based compensation and the increase in earning management practice is no coincidence. In a testimony to the Senate Banking Committee in 2002, the Chairman of the Federal Board in USA Alan Greenspan pointed that the business community has developed some greed where companies executives looked for ways 'harvest' of stock market gains. As a result, of the attractive spread of shareholding and options among corporate managers it negatively created incentives to artificially inflated reported earnings in order to maintain stock prices high and rising. The result indicates that the options were poorly structured and in addition, they failed

to suitably arrange the long-term interests of shareholders and those of the managers” the model which is so important for effective corporate governance. The incentives that were created overcame the rationale judgment of most corporate managers. It is not that humans beings have become any greedier than the past generations beings, it is that the opportunity to express greed has grown big. According to Reinstein and Coursen, (1999).The earning management practice cost the US economy \$400billion per year and has cost large audit firms over \$1billion to settle professional lawsuits over the last 10 years

In 1602, Dutch East India Company was founded in the Netherlands as a trading corporation. It is widely deemed to be the first company to issue shares of stock and become a public company (Albrecht et al., 2004). It emerged with the modern idea of stock, stakeholders and public ownership. In recent decades, four centuries after Dutch East India Company came up with the concept of public ownership, there is a very high abuse in companies of that concept leading to high scale fraud, the bankruptcy of major companies and the disappearance of wealth frauds have raised questions about the responsibility of management which involve CEO's, senior managers and other officers (Albrecht et al., 2004).

Forensic accountants and auditors have found that there are three elements of fraud namely, concealment, theft and conversion. A fraud is caused by perceived pressure, perceived opportunity and rationalizes (Rezaee, 2002). Kenya was among the first countries to adapt International Finance Reporting Standards (IFRS) but according to the worldwide survey carried out by PriceWaterHouseCoopers in November 2011 which they term as the Sixth Global Economic Crime Survey, Kenya was leading among territories that reported high level of fraud (40% or more) both in developed and growing economies. The survey stated that if an internal audit department has fewer people, the chances of identifying fraud will be reduced and chances of the management committing fraud will increase (PriceWaterHouseCoopers, 2011). The Global Economic Crime Survey (2011) indicated that fraud done in 2011 targeting firms around the world found out that, 41% was done by middle level managers, 18% was done by senior executives, and 39% was done by junior staff members and 2% done by other employees. This out rightly expressed that management are the biggest fraudsters since it is adding up to 59% of fraud done which is made up of middle management and senior executives.

Most people may wonder how management can manipulate earnings. Under the General Accepted Accounting Principles corporates use accrual accounting method and it entails the

recording of the financial effects of transactions and other activities that have cash consequences for the business in the periods which the transaction took place rather than only in the period in which cash is received or paid by the entity. The accrual accounting method gives managers discretion in determining the actual earnings a firm reports in any period. Managers have control over the timing of actual expense items and to some extent, alter the timing of revenue and expenses recognition (Ruth and Tariq, 2009)

1.2 Statement of the Problem

Fraud has made many well performing firms like Enron, Sunbeam, Cendet and Waste Management in U.S to go down. Even before the collapse of Enron, the U.S. Securities and Exchange Commission was probing more companies with possible accounting fraud (Schnatterly, 2003). There is confirmation that earnings management practice is growing with time and becoming a common practice within corporate organizations (Jooste, 2011). According to International Financial Reporting Standard, financial figures should have integrity and should not be the results of manipulations specifically made to increase the reported income of an entity. Therefore earnings should be reliable and reflect the true position of the earnings strength of the company.

Scandals as from 2000 to 2012 involving Nairobi Securities Exchange (NSE) listed companies dented investor confidence in Kenya which resulted in pulling down the country's standing in the year 2012 list of global competitiveness (World Economic Forum, 2012). Kenya which is the largest economy in East Africa was position 106 most competitive economies out of 144 countries surveyed down from position 102 it held in 2011 this is according to the World Economic Program (WEP) 2012 held in Geneva, Switzerland. The report states that Kenya dropped as a result of unethical behavior of firms that led to frauds and corruption, integrity of auditing and reporting standards, strength of investor protection and the protection of minority shareholders.

Boardroom wars as from 2000 to 2012 and the resulting negative publicity has adversely affected investor's perception of listed companies' in Kenya (Mugwe, 2012). The boardroom wars were partly triggered by poor corporate governance, alleged corruption and mismanagement of investors Funds raising the questions as to how well Investors are protected in Kenya. Among the top companies with board room wars were CMC and East Africa Portland Cement, a number of Kenyan companies have collapsed among them are Uchumi Limited, Nyaga stock brokers, Discount Securities, Ngenye Kariuki stock brokers etc

.Earning management may impact shareholders and other stakeholders by giving them false information which show the false image of the company financial position and later to collapse (Ruth and Tariq, 2009). Although prior researches have covered earnings management practices in developed countries, this study will cover earnings management in the developing countries and to be specific Kenya. For many years companies like Enron and Worldcom were viewed as icons and symbols of business success and role models but they became images of greed and unethical behavior (Jooste, 2011).

According to Capital Market Authority (CMA) acting chief executive Paul Muthaura, “there is an increase in inaccurate financial statements that expose investors to risks that can dent confidence in the bourse.” He further exclaimed that, “Companies involved could collapse along with billions of shillings in public investments, if rogue auditors are left to release misguided reports,” adding that “there is urgent need for an oversight board.”

Many Kenyans felt that the Uchumi management board was not being truthful about the reasons which had led to the collapse of this company partly owned by the government and shareholders. In the heated arguments that have followed Uchumi’s collapse, there were recurring hints that corruption and other unethical practices of earnings management within the companies board might explain the losses of the retail giant. Because, the Uchumi financial statements showed a healthy financial performance and position of the company and that it was a going concern entity whereas it experienced serious cashflow problems and other financial difficulties that led to its collapse in 2006 which surprised many. Therefore this research seeks to answer the question: Are most companies collapsing as a result of sustained earning management practice and what are motivational factors for earning management practice in Kenyan public listed firms?

1.3 Objectives of the Study

1.3.1 General Objective

- i. Establish earnings management practices by the management of public listed companies in Kenya.

1.3.2 Specific Objectives

- i. To examine the motivation behind the practice of earnings management in public listed corporations in Kenya.
- ii. To examine how earnings management is practiced in public listed corporations.
- iii. To examine the relationship between incentives structures and the practice of earnings management in public listed corporations.

1.3.3 Research Questions

The questions in the study addressed the following:

- i. What motivates earnings management practices?
- ii. How does the organization practice earnings management?
- iii. What is the relationship between incentives structure and earnings management practice?

1.4 Significance of the Study

The study findings are important to business fraternity as a whole. Owing to the fact that corporate scandals are on the rise in Kenya which are caused by frauds and corruption. This justify as to why we need to study the motivation factors in earning management practice in public corporation of Kenya. This study will be of importance to public companies shareholders and other corporate stakeholders like government, creditors, debtors, financial analysts. It will expose the organization fraudulent practices, how the practice is done and motivations behind the practice. To the scholars the findings of this study will contribute to the pool of knowledge in earnings management practices and motivations behind them and thereby provide insights on fraudulent financial reporting among others. This paper shall contribute to the earning management literature. Although earning management has in recent past received much attention in the accouting and audit literature, little is known about the motivations of earning management. The paper will extend research on motivations of earning management.

1.5 Scope of the Study

The study covered public listed corporations. The population targeted for this study were all the public listed corporations in Nairobi Stock and Security Exchange Market as at 31st. March. 2013.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Chapter two has the review, definitions of Earning Management, accounting theories related to earning management, methods of earning management practices, motivation of earning management practice.

2.2 Earning Management

The current business environment which has the influence of economic downfalls has fixed the top management of corporates into having pointed attention of how to make financial statements ‘look good’ for the reason of attracting investors. The intensive pressure and demand from stock market expectations, market analysts, forecasts and earnings targets has heaped another heavy load to management. Stock bonuses that managers receive are incentives of high earnings. Due to this too much pressure; many corporates have used earning management too in order to achieve those targets. It is the biggest con trick; earning management itself is legitimate and acceptable, especially when viewed in accordance of making choices among acceptable alternatives. Accounting rules and regulations allows some room of making choices among different accounting practices (Albrecht et al., 2004).

Financial statements fraud cases have described various methods of earning management used to commit fraud. They are revenue recognition illegitimately, inappropriate deferral of expenses, fiction of sales and early sales, reversed or used of unjustified reserves (Rezaee, 2002). Earning management is normally discussed in relation with financial statements fraud. The rising issue of earning management fraud fastens the need to define ‘earning management’, many accountants accept that some earnings management techniques are not fraudulent and managers to managers earnings (Magrath and Weld, 2002). They further say that the management used accounting choices consistent with GAAP (General Acceptable Accounting Principles) to handle earnings. In exercising its assigned managerial duties, much of these assignments involve judgments and estimates within GAAP. Because the line between legitimate earnings management and fraudulent accounting practices is delicate, it is easy for the management to go beyond the border in order to meet the earnings expectations. The former SEC United States (Security Exchange Commission) Chairman, Arthur Levitt, in his 1998 ‘number game’ speech articulated the view that “to many corporate managers,

auditors and analyst let the desire to meet earnings expectations override good business practices” (Margrath and Weld, 2002).

Different academicians, researchers, practitioners and various authoritative institutions have different meanings and names over earnings management. Some refers it as creative accounting (Catherine and Orial, 2005) (Tiina and Linh, 2002). Catherine and Orial defines it as process of altering the content of the message being transmitted that deliberately distant the communication between entities and shareholders. The preparers who are the management are attracted in creating the financial statements to go well with their own purposes and interests. They classify creative accounting or earning management into micro and macro manipulation. It is the continuous selection of accounting measurement of reporting rules in a particular model, whose effect is to report income with a smaller variation from trend than would otherwise have appeared (Copeland, 1968), (Pravean Nisen, 2009) refers earning management as corporate fraud, (Lawrence, 2009) calls it fraudulent financial reporting. It has more names related to it but the bottom line is that there is no single universally accepted meaning of the term earnings management.

2.3 Accounting theories related to Earning Management

2.3.1 Agency Theory

Agency Theory is forecasted on the doctrine that individual agents choose actions that maximize their personal utility. In the modern corporation; there is a partition between the individuals making decisions that we refer them as managers and people bearing the wealth consequences of those decisions who are regarded as shareholders (David. et al, 1999). In some situations like fraudulent earning management, managers may opt to undertake deeds that are not in preferences of shareholders. Agency Theory forecast about managerial functions and corporate diversification strategies. If managers obtain private benefits from broader horizons that exceed their private costs, agency theory forecast that managers will still maintain a diversification plan even if doing so decreases shareholders wealth (David. et al, 1999). Agency Theory which is the contract between the owners of financial resources (the principals) and managers (the agents) who are mandated with using and controlling that wealth is based on the reality that agents have more information than principals and that this information unevenness adversely affects the principals capability to monitor effectively whether their interest are being properly served by agents (Michael, 1994). Agency Theory is

also based on hypothesis that principals and agents act rationally and that they will use the contracting route to maximize their wealth (Michael, 1994).

Earnings management is majority practiced by senior management in a company. It means that because managers who are the agents have personal interest, there is possibility for them to take the opportunity to act against the interest of the owners of the firm. Managers may sometimes not act in the best interest of shareholders when the control of company is different from its ownership (Livia et al., 2007). Livia further states that managers can be 'satisfiers' rather than 'maximisers' that is, they play it safe and look for a suitable level for growth because their main concern is to perpetuate their own existence rather than maximizing the value of the firm for its shareholders. Shareholders hands over the decision making authority to the agent (CEO) with the belief that the agent will act in their best interests.

An inclusive theory about agency theory by Jensen and Meckling (1976) indicated that the principals who are the company owners can comfort themselves that the agent will make the most favourable decisions only if appropriate incentives and rewards are given and only if the agent is watched. Incentives involves things like stock options, bonuses and many other benefits which are related with how fine the results of management's decisions serve the interests of shareholders. Monitoring components are bonding the agent, regular checks of management prerequisites, financial audits and inserting limits on management decisions.

2.3.2 Stakeholder Theory

Shareholders are one of the very important stakeholder groups like customers, suppliers, employees and local communities (Joseph and Wayne, 2004). They articulate that as business owned special and specific duties to its investors, they also have different duties to the various stakeholders groups. A firm has special duties to other stakeholders as it has to shareholders. A corporate board must ensure that the company respects its legal and contractual obligations to other stakeholders. Every party of the stakeholders of Enron was adversely affected when its senior managers conspired against the interest of the shareholders and when investors had no confidence in the company (Joseph and Wayne, 2004). Time has proven that managers may sometime misappropriate or destroy not only millions, but billions of dollars worth of company assets, when they get chance to do so, for instance, the

extravagance and waste that occurred at RJR Nabisco during the 1980s were due to the failure of imposing effective discipline upon management (Burrough and Heylar, 1992) managers at RJR Nabisco had a fleet of 10 private jets and 36 pilots at their control together with a private hanger at the Atlanta Airport to service and maintain the fleet. Additionally, this was complimented by a different three- story facility to serve as a waiting lounge. The second was built as appointed under clear instructions and order from the Chief Executive Office of the company that the budget was ‘unlimited’ (Burrough and Heylon, 1992). We can’t validate a system of stakeholder governance in the innocent assumption that managers must be or can be motivated to act in the stakeholders’ interest instead of their own (Joseph and Wayne, 2004).

2.4 Methods of Earning Management Practices

Academicians have used a variety of measures while attempting to address the level of earning management and have attempted to find conditions under which it is practiced (Lawrence, 2009) More and more attention should be directed in defining and measuring earnings management and that academic research should focus largely on capital market incentives (Dechow and Skinners, 2009). In relation to Dechow and Skinner statement, where they demonstrated that reporting earning follow certain patterns that are related to avoiding losses, slow increase in quarterly earnings, meeting analysts estimates targets and issuing equities (Lawrence, 2009). He discloses more and says that earning management may be restricted in a given accounting period by the growing overstatement of assets from prior earning management. McVay, (2006) observes that accounting accruals and ‘real’ earning management, earning management can occur through manipulating important elements of earnings. Earnings management has a sole edge on the income statement, although the apparent association to the balance sheet and accruals is an important part of an understanding of earning management. Standard setters are adopting a balance sheet emphasis, which targets on the valuation of assets and liabilities, rather than on income statement approach, which stress on the income statement measurement (Lawrence, 2009).

2.4.1 Good will and Intangible Assets

In Catherine and Oriol (2005), they expressly showed how earnings management is technically practiced in USA, the technical issues that arises where the accounting of the acquisition is done is that in many acquisitions, it appears that there is a difference between the price paid for the business and the value of the net assets acquired by the company. The

difference is referred to as goodwill. If treated as an asset and amortized, it can have a significant impact on depressing reported profits. A different accounting treatment is treating goodwill as an asset, but not amortizing it regularly. As an alternative, the asset would be tested regularly for 'impairment' that is; tested to check if its value has decreased. Only if it can be proved that it has reduced value, would there be any impact on profit either increase or decrease. The amortization of goodwill created an opportunity for some creative earning management of either increasing profit if the amortization is of less value or reduce profit if it is high. COSO (Committee of Sponsoring Organization), (1999) report and (Janet et al., 2006) indicated other methods of how earning management is fraudulently practiced namely; Inappropriate revenue recognition, overstating assets besides accounts receivable, understating expenses / liabilities, misuse and embezzlement of assets and inappropriate disclosure.

2.4.2 Improper Revenue Recognition

The revenue recognition crisis usually involves recording revenue before it is earned, which is before a sale is through, or before a product has been delivered to the customer or while the customer can still void or delay the sale (Rezaee, 2002). Rezaee articulates that revenue should only be recognized when the goods and services are delivered to its customers not before delivery. Improper recognition also involves fictitious sales.

2.4.3 Stock Management

According to Stephen et al., (2002), stocks form a significant portion of corporate assets, both in size and proportion to all other assets on the balance sheet. Second, there are numerous accepted stock valuation methods. Third, valuation of stocks becomes difficult due to factors like obsolescence, and the necessity to allocate manufacturing costs of stocks. Fourth, mostly are in different locations which make physical control and counting difficult and complicated. These factors make stocks more affected by the earning management practice. Aren and Loebbecke (2000) emphasized that stock comprises of two different but related systems. First is the related cost and second is the actual physical flow of goods. They identified five parts of stocks systems namely, acquiring and recording of the raw material, labour and overheads, internal transfer of assets and related costs, shipping of goods and recording revenue and

costs, physical observation of stock, pricing and compiling stock. These are the mostly affected areas by the fraudulent practice.

2.5 Motivation for the practice of Earnings Management

Earning Management is fraud practiced within the generally accepted accounting principles (Merle et al., 2006). He continues to say that a number of the largest accounting frauds in history that have occurred in the last several years have made legislators, regulators, practitioners and academics to search for the forces that made the frauds to occur which is a necessary sign to effectively prevent future occurrences. It has been suggested that the best explanation lies in the incentives and opportunities for personal gain forced by executives (Merle et al., 2006).

2.5.1 Incentives

Merle et al., (2006) stated that the rise of managers wealth is attached to the stock-based compensation and the resulting equity holdings is the executive compensation. Jenter (2001) and Aboody and Kaszrik, (2000) argued in contrast that share options are not the best way to compensate managers. Managers use the option grants for their own benefits, stock option do not show practical relations consistent with the economic motivations behind them (Yermack, 1995).

However, (Merle et al., 2006) continues to argue that management incentives which are based on company performance can persuade managers to misreport performance. He further asserts that non-alignment in pay-for-performance systems entices managers to cheat and such lying is so persistent that firms would be better to adopt a linear pay-for-performance system.

Alan Greenspan, then the Chairman of the Federal Board in USA, in his semiannual monetary policy report to congress on July 16, 2002, affirmed that “the business community has developed some greed where companies’ executives looked for ways ‘harvest’ of stock market gains. As a result, of the attractive spread of shareholding and options among corporate managers it negatively created incentives to artificially inflated reported earnings in order to maintain stock prices high and rising. The result indicates that the options were poorly structured and in addition, they failed to suitably arrange the long-term interests of shareholders and those of the managers” the model which is so important for effective corporate governance. The incentive that was created overcame the rationale judgment of

most corporate managers. It is not that humans beings have become any greedier than the past generations beings, it is that the opportunity to express greed has grown big. We see more evidence in Berrie Ebbers Case, who was WorldCom CEO. According to the prosecutor Ebber was motivated to do fraud when there was pressure on share price. The prosecution further stated that Ebber's personal wealth was based on WorldCom shares and he had borrowed \$ 400 million using those shares as the collateral (Ackman, 2005). Capital markets have played a great role in many recent corporate fraudulent scandals. It has relied on failure of financial markets to defy value- increasing investment instead of relying on managerial myopia, communication and contacting restriction, multitasking, or investor irrationality (Kumar and Nisan, 2009).

2.5.2 Wealth Increase

Trading triggered by inside information is prohibited by CMA (Capital Markets Authority). However, managers who commit financial statement fraud through earning management are likely to use their knowledge about the fraud to protect or increase their wealth (Summers and Sweeney, 1998) they also revealed that the characteristics that lead to the commission of the fraud are also likely to lead to breaking of insider trading rules. Insiders can exploit their private knowledge of overpriced stock resulting from fraudulent financial information by either anticipation of subsequent price declines and or reducing their purchases of securities. Insiders are expected to employ high levels of sales and low levels of purchases of corporate stocks. The usefulness is partly defined by security of the job, which is maximized through the production of smooth or increasing earning streams (Summers and Sweeney, 1998).

2.5.3 Poor Financial Condition

Poor financial condition may motivate earnings management where the action intention is to get better appearance of the company's financial position, may be to reduce the hazard of loss of employment, or to gather many resources before termination (Summers and Sweeney, 1998). They continued to say that weak internal control environment in a business allows the occurrence of a fraud.

2.5.4 Shareholders Expectations

Since primary orientation assumed to be guiding companies is profitability. (Gordon, 1964 cited in Summers and Sweeney, 1998) noted that profitability is negatively affected by the manager's own utility maximization. That usefulness is partly defined by job security, which

is then maximized by producing smooth or increasing earnings streams. The implication is the expectation that management will maintain or improve past levels of profitability, despite of what those levels were. This expectation, if not met by real performance, it will provide motivation of earning management practice.

2.5.5 Company Growth

Unethical managers may be attracted to misstate financial statements when growth slows to maintain the appearance of consistent growth of the company (Summers and Sweeney, 1998). They also noted that rapid growth and sustained growth could influence the likelihood of fraud in different ways, rapid growth is thought to lead to weaknesses in internal control, while sustained growth is accompanied by structural changes that create role and responsibility uncertainty.

2.5.6 Accounts Receivable/Inventory

Accounts receivable and inventory are noted as two such accounts due to the judgment involved in estimating uncollected accounts and obsolete inventory. Because subjective judgment is involved in determining the value of these accounts, management may use these accounts as tools for financial statement manipulation (Summers and Sweeney, 1998).

2.5.7 Auditors Turnover

In as much the majority of auditor changes are legitimate reasons, the risk of audit failure and subsequent litigation is higher during an initial engagement than in subsequent years (Stice 1991; St. Pierre and Anderson 1984 cited in Summers and Sweeney, 1998). Summers and Sweeney suggested that a client may even change auditors in order to reduce the likelihood of detection of a financial statement fraud.

2.6 Incentive Structures and Earning Management

Ball (2001), states, the global discussion talks much on the standards and little on the role of institutional factors and market forces in shaping firms' incentives to report informative earnings. In attempting to hold standards constant and to isolate the influence of reporting incentives, the researcher complements the studies by Ball et al., (2003) and Ball and Shivakumar (2002). Ball et al., (2003) examine and analyze earnings timeliness and conservatism for four East Asian countries that have accounting standards same to common law countries, but differ in company structures. They show that despite having the same

accounting standards the earnings properties of the East Asian countries are different from those in common law countries, like the U.K. or the U.S. Ball and Shivakumar (2002) compare the timeliness of loss incorporation for private and public firms in the U.K. and proves the evidence that is consistent with the notion that privately held firms exhibit lower earnings quality than publicly traded firms.

Treatment of incentives has been given little attention in the international accounting discussions. Most of the discussion has relied on accounting standards only, which has been viewed as the primary input for high quality accounting (Levitt, 1998). In relation with this observation, numerous countries have adopted or planning to adopt International Financial Reporting Standards (IFRS) in an effort to improve the quality of accounting. Likewise, harmonization efforts within the European Union (EU) have specifically focused on reducing differences in accounting standards across countries (Van Hulle, 2004). Accounting standards generally grant ample flexibility to companies. Measurements are mostly on private information and the use of standards involves judgment. Corporate insiders can use the resulting decision in reporting to show information about the firm's financial performance, but they may also misuse discretion when it is in their interest. For this reason, reporting incentives are likely to play an important role in determining the quality of information of reported accounting numbers. This insight is not new (Watts and Zimmerman, 1986), it is often ignored in international standard setting.

Privately owned firms and those with publicly traded debt or equity securities face very different demands for accounting information. Raising capital in public markets creates strong incentives to provide information that is useful in evaluating and monitoring the firm. Investors in public markets generally do not have private access to corporate information and therefore rely heavily on information that firms provide. Financial statements and, in specific, earnings play a vital role in monitoring traded claims against the firm (Ball, 2001). External investors are aware of potential conflicts of interests and the fact that corporate insiders prepare the financial statements. Hence, they will be reluctant to supply capital to firms with low quality financial statements. That is, in price protecting and demanding a higher cost of capital, investors provide incentives to report financial information that reflects economic performance. In contrast, privately held firms have relatively concentrated ownership structures and hence can efficiently communicate among shareholders information via private channels. Therefore, financial information and reported earnings are less important in

communicating firm performance, which in turn makes private firms less likely to expend resources for example hiring a high quality auditor to produce earnings that are highly informative about economic performance (Shivakumar, 2002).

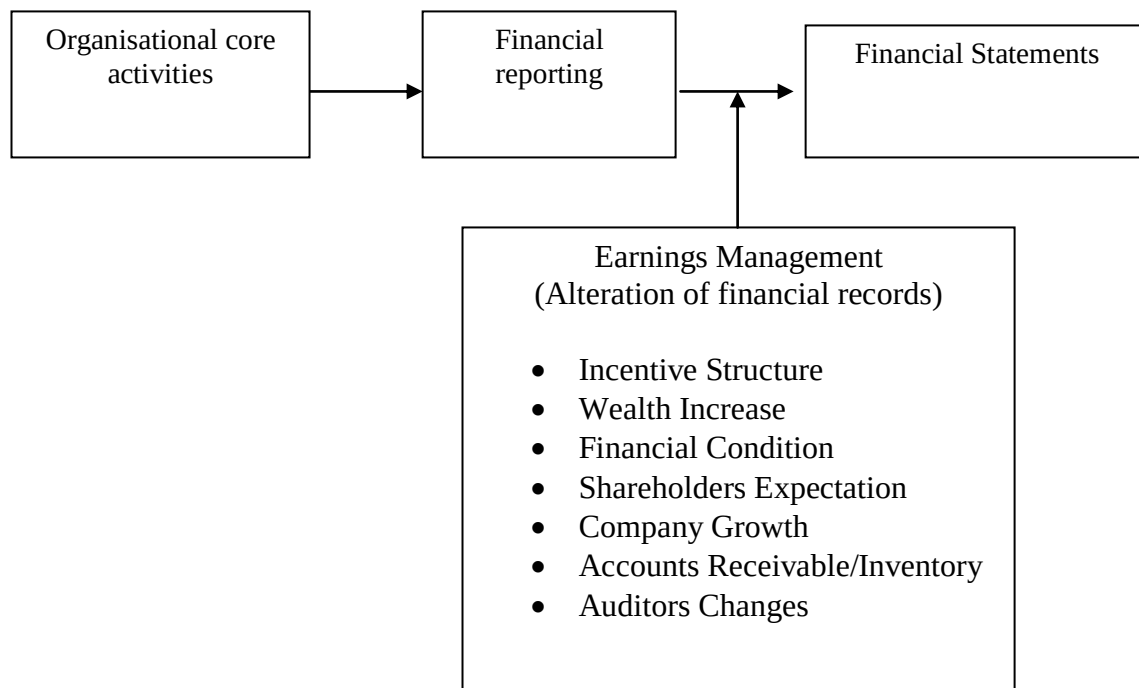
Moreover, reported earnings can assume a different role than for public firms. For instance, private firms face less of a tradeoff if they manage earnings to minimize taxes but make them less informative in the process. Alternatively, earnings can be used in determining dividends and other payouts to stakeholders in the firm. For instance, Leuz et al. (2003) argue that private control benefits and expropriation from outside investors create hiding incentives for corporate insiders. That is, public firms with agency problems between controlling insiders and outside investors may mask firm performance by managing reported earnings to prevent outsider intervention. But similar incentives can arise for private firms, which rely heavily on debt financing from banks and use financial statements to inform banks about their performance.

Another argument why public capital markets can create incentives to reduce the informativeness of earnings in specific situations is based on earnings targets. Beatty et al. (2002) argue that small investors in stock markets are more likely to rely on simple heuristics such as earnings targets than fairly sophisticated private investors such as banks, which makes public firms more likely to engage in earnings management to exceed targets. Similarly, public firms may manage earnings to meet or beat capital market expectations as expressed in analyst forecasts. Stock based compensation contracts can further exacerbate these incentives (Guttman et al., 2003). Consistent with these arguments, Beatty and Harris (1999) and Beatty et al. (2002) present evidence from the banking industry suggesting that public banks engage in more earnings management than their private counterparts.

2.7 Conceptual Framework

The conceptual framework presents the relationship between the dependent (predicted) variable and the independent (predictor) variables.

Figure 2.1: Conceptual Framework



Every organisation has its core function which form the daily routine operation. Over specified periods of time, these activities are required to be reported on their financial position. Book keeping activities form the core of the finance department. Book keeping activities are the foundation of the financial statements.

In the process of translating the book entries into financial statements, the temptation towards earnings management is expected in many firms. These may be triggered by among incentive structure, wealth increase, financial condition, company growth, accounts receivable and auditors' changes other things.

2.8 Operationalization of Variables

In establishing the relationship between earnings management and motivation towards the practice, a multiple regression was (Summer and Sweeney, 1998). The multiple regression equation is given as follows:

$$EM = \alpha + \beta_1 I + \beta_2 W + \beta_3 PFC + \beta_4 SE + \beta_5 CG + \beta_6 AR + \beta_7 AC + \varepsilon$$

Where:

EM = Earnings Management. This will be measured by the extent of accounting manipulation and the number of time revenue is recognized in the wrong period.

I = Incentives. This will be measured by stock ownership, debt to equity and other insiders and variability of returns (Latham and Jacobs, 2000).

W = Wealth Increase. This will be measured by number of shares the management people have and the number of transactions for purchasing and selling in a given period of time (Summer and Sweeney, 1998).

FC = Financial Condition. This will be measured using Altman Z scores (Altman and McGough, 1974). It computed as below:

$$Z=1.2X1+1.4X2+3.3X3+0.6X4+1.0X5$$

Where:

X1= (Current assets- Current liabilities)/total assets

X2= Retained earning/total assets

X3= Earnings before interest and taxes/total assets

X4= Market value of equity/BV of total Liabilities

X5= Sales/Total Assets

The calculation of Altman's Z is based on information from the year prior to the year of fraud occurrence.

SE = Shareholders Expectation. This will be measured using return on asset (ROA) which is calculated as the net income before extraordinary items by total assets (Summer and Sweeney, 1998).

CG = Company Growth. This will be measured using simple average of the percentage growth in sales for the last three-year window ending in the year before the fraud occurred (Summer and Sweeney, 1998).

AR = Accounts receivable/Inventory. This will be measured as the ratio of receivables (inventory) to sales for the year less the ratio of receivable (inventory) to sales in the previous year (Summer and Sweeney, 1998).

AC = Auditors Changes. This will be measured by using variable representing a new client to be (1) and an existing or established client to be (0). A client is considered new if the auditor has been with client for two years or less (Summer and Sweeney, 1998).

ε = Error term

In relation to the objectives of the study the researcher used SPSS to estimate the following multivariate regression analysis covering motivation factors for earnings management in listed public corporations as shown below:

$$R = \beta_0 + \beta_1 I + \beta_2 W + \beta_3 FC + \beta_3 SE + \beta_3 CG + \beta_3 AR + \beta_3 AC + \varepsilon$$

2.9 Chapter Summary

This chapter covers various issues touching on the topic including earning management, accounting theories related to earning management, methods of earning management practices, motivation for the practice of earnings management and incentive structures and earning management.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section illustrates the procedures and methods that were used in the study; the research design, population, data collection methods and analysis.

3.2 Research Design

The study was exploratory in nature because it sought to determine the main factors that might lead to earning management practice in Kenya (Latham and Jacobs, 2000). The study is also diagnostic because it attempted to establish the relationship between the incentives awarded to management and earning management practice (Albrecht et al., 2004). According to Cooper and Schindler (2009) explanatory research design is structured with clear investigative questions and can be used to discover associations among different variables. This corresponds to the aim of the study to investigate motivation factors for earning management practices in listed public corporation in Kenya.

3.3 Population and Sampling

The target population was all the 56 active listed public companies as at 31st.March.2013. From the foregoing introduction on the topic, the population of study covered public listed companies in Kenya. The respondents were the accountants of the institutions (Stephen et al., 2002) or persons charged with overseeing the finance function in the institution. All the 56 listed organisations were selected for the study.

3.4 Data Collection and Description

The data used for this study was primary. Primary data included first-hand information that was collected by the use of online questionnaires.

The questionnaire was therefore the main data collection instrument that was used in this study. In seeking to address the first objective of the study, data collected was used to assess the causes of the practice. The aspects to be analyzed, for example causes were measured by way of a Likert scale because responses are more reliable and easy to use by respondents (Stephen et al., 2002).Any supplementary data that was considered relevant was collected

from secondary sources such as Capital Market Authority, audit firms such as Deloitte, PricewaterhouseCoopers, and KPMG, etc.

The researcher emailed questionnaires to finance department of all the targeted firms. A follow up call was made after every two days. In a two weeks period the targeted population filled the questionnaires and sent them back to the researcher.

3.5 Data Analysis

The data collected was analyzed using descriptive statistics, correlations, and linear regression analysis. This was achieved through the use of Microsofts' Excel and SPSS computer packages. The use of multiple regression model was adopted since it a suitable tool to use in studying relations between variables (Moyes and Hasan, 1996; Stephen et al., 2002; Summer and Sweeney, 1998; Latham and Jacobs, 2000). The researcher chose Regression analysis because of the relational nature of the variables in the study.

In establishing the relationship between earning management and motivation towards the practice, a multiple regression was used (Summer and Sweeney, 1998). The multiple regression equation was given as follows:

$$\text{Earning Management} = \alpha + \beta_1 \text{ Incentives} + \beta_2 \text{ Wealth increase} + \beta_3 \text{ Poor financial conditions} + \beta_4 \text{ Shareholders expectations} + \beta_5 \text{ Company Growth} + \beta_6 \text{ Accounts receivable/inventory} + \beta_7 \text{ Auditors changes} + \varepsilon$$

The significance of the variable relationship was indicated by various measures such as the coefficient of determination (R Squared) and the P Values. The main significance was given by the P value where a factor less than 0.05 indicate a significant positive or negative relation.

3.6 Research Quality

Data validity was achieved by the researcher through ensuring research is measuring what it claims to be measuring. The researcher gathered data in accordance with the reasearch objectives through ensuring the questions in the questionnaire are direct so that the research really captures the information the way the researcher intends.

Research reliability on the other hand was achieved by the researcher by making sure that the method of data gathering used led to consistent results. This was achieved by having different

researchers follow the same methods to see if results can be duplicated. If results are similar then it is likely that the method of data gathering is reliable.

3.7 Ethical Considerations

In conducting the study, the researcher adhered to research ethical guidelines. Individual consent was the basis for one to participate in the study. No respondent was coerced into giving information he/ she feels was not worth revealing in terms of security or personal reasons. Information was treated with confidentiality and data collected was used for the purpose of this research alone and was revealed to any other party with need to carry out a similar study. To avoid plagiarism, all sources cited in the study were acknowledged. Data collected was presented and analyzed as accurately as possible. Furthermore, all persons who contributed to the success of the study were acknowledged.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the analysis of the study findings according to the data collected from the field. It provides information on the motivation factors for earnings management practice in Kenyan public listed corporations. It begins with instrument return rate, demographic data of the respondents, while the other sections are based on the research objectives of the study.

4.2 Response Rate

The researcher targeted all the active firms listed on the NSE as of 31st December 2012. There were 60 listed firms with 56 classified as active and were involved in the study. Out of the 56 questionnaires issued, only 33 responded giving a response rate of 59%. This presented about half of all the listed companies and the data collected were therefore deemed to be representative of the entire population.

4.3 Department Worked by Respondents

The researcher sought to find out whether the respondents work in the finance department. The finance department has the right information to answer the questions on earnings management sufficiently. The results of the responses were as shown in Table 4.1.

Table 4.1 Distribution of respondents by department worked

Station worked	Frequency	Percent
Finance department	31	93.9
Non finance department	2	6.1
Total	33	100.0

The findings indicate that 94% of the respondents worked in the finance department while 6% of the respondents worked in other departments other than finance. This implied that the data collected was credible enough having been solicited from people who are knowledgeable on finance matters and especially earnings management.

4.4 Motivation behind the practice of earnings management

The first objective of the study was to establish the motivation behind the practice of earnings management in public listed corporation in Kenya. The respondents were presented with a set of 7 questions regarding earnings management practice. They were required to indicate the extent to which they agreed with the statements. The first question was on management incentives that are based on financial performance. The results were as shown in table 4.2

Table 4.2 Effect of management incentives

Response	Frequency	Percent
Strongly Agree	9	27
Agree	19	58
Disagree	4	12
Strongly Disagree	1	3
Total	33	100

As seen from Table 4.2, 85 % of the respondents believed that management incentives that are based on company performance induce managers to mis-report financial performance with only 15 percent responding to the contrary. This finding implied that companies that have incentives for top management that are based on performance were more likely to be involved in earnings management practice.(Merle et al.,2006),had argued that management incentives which are based on company performance can persuade managers to misreport financial performance. The above finding proves his argument.

When the respondents were asked on the influence of purposeful possession of the company shares by management with the intent of selling them to increase their wealth, the results were as shown in Table 4.3.

Table 4.3 Effect of possession company's shares by its management

Response	Frequency	Percent
Strongly agree	9	27
Agree	10	30
Not sure	6	18
Disagree	6	18
Strongly disagree	2	6
Total	33	100

Findings on purposeful possession of company's shares by its management with intent to sell them to increase their wealth show that 58% of the respondents believed that the situation influenced the earnings management practice. On the other hand 24% of the respondents believed ownership of shares by management did not influence the practice, while 18 percent were not sure about its influence on the practice. This finding implied that, organizations with policies that allowed their managers to own their shares and to easily trade with them were more likely to be affected by the earnings management practice.(Summers and Sweeney,1998),managers may practice earning management to increase the value of their shares and thus increase their wealth.

The results on the effect of poor financial performance of a company in view of its public reputation were as shown in Table 4.4

Tale 4.4 Effect of poor financial performance in view of public reputation

Response	Frequency	Percent
Strongly agree	9	27
Agree	19	58
Not sure	2	6
Disagree	1	3
Strongly disagree	2	6
Total	33	100

Findings in Table 4.4 show that 85 percent of the respondents believed that poor financial performance of a company is always at stake and in view of its public reputation; poor performance was major cause of the earnings management practice. Only 9 percent of the respondents believed otherwise with a further 6 percent as not sure about this relationship. This finding implied that firms with higher public reputation were more likely to engage in earnings management practice and especially so if negative publicity translated to loss of revenue and profitability to its operations. (Gordon, 1964), stated that the profitability orientation is directed by the management's own wealth maximization intention. The intention is also defined by job security, which is increased by producing smooth and increased earning streams. Results on the shareholders expectations were as shown in Table 4.5

Table 4.5 Effect of high shareholders' expectation on profitability.

Response	Frequency	Percent
Strongly agree	17	52
Agree	11	33
Disagree	4	12
Strongly disagree	1	3
Total	33	100

Findings in Table 4.5 indicate that 85 percent of the respondents believe that high shareholders expectations from management in terms of high profitability were also responsible for the earnings management practice. Only 15 percent of the respondents were of the opinion that shareholder' expectations were not responsible for the practice. The finding implies that organizations that place very high expectations on their shareholders in terms of dividend payout were more likely to engage in the earnings management practice than those whose shareholders expectations is moderate or low (Gordon, 1964), the expectation that management will be in a position to maintain and improve previous level of profitability, regardless of what those levels were. The expectation, if not met by actual performance, it provides a motivation of earning management.

Results on the internal control systems of the companies are as shown in Table 4.6.

Table 4.6 Effect of internal control systems within companies

Response	Frequency	Percent
Strongly agree	7	21
Agree	16	49
Not sure	1	3
Disagree	6	18
Strongly disagree	3	9
Total	33	100

As is seen from table 4.6, 70 percent of the respondents believe that weak internal controls systems could encourage earning management practice within the companies. Whereas 27 percent of the respondents believed that weak internal controls were not responsible for the practice, three percent of them were not sure. This finding implied that weak internal control systems encouraged some firms to engage in the earnings management practice.(Beasley,1996),Unethical managers are induced to misstate financial statements, changes like company structure and poor internal control systems motivates the perpetration of fraud. Results on adjustments of accounts receivable and inventory were as shown in Table 4.7

Table 4.7 Effect of adjustments of accounts receivable and inventory

Response	Frequency	Percent
Strongly agree	7	21
Agree	6	18
Not sure	7	22
Disagree	9	27
Strongly disagree	4	12
Total	33	100

Results in table 4.7 reveal mixed results that management's subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures were responsible for earnings management practice. Whereas 39 percent of the respondents agreed that it was responsible for earnings management practice, another 39 percent disagreed while another 22 percent were no sure. The mixed reactions from the respondents could be as a result of the treatment of accounts receivables and inventories in the balance sheet, where the valuation of the two items is guided by specific international financial reporting standards

which the listed firms have subscribed to (IAS 2, 2013). Results on external auditor turnover were as shown in Table 4.8

Table 4.8 Effect of high external auditor turnover

Response	Frequency	Percent
Strongly agree	2	6
Agree	8	24
Not sure	7	21
Disagree	12	37
Strongly disagree	4	12
Total	33	100

A result in Table 4.8 also reveals mixed reactions on high external auditor turnover, where organisations changed auditors after every one or two years. Whereas 30 percent of the respondents agreed that high auditor turn over encouraged earnings management practice, 49 percent disagreed with a further 21 percent of the respondents not sure about its effect. The mixed reactions could be as a result of the auditors being guided by the international financial reporting standards which all auditors in the listed firms apply in their financial reporting. Since specific items in the balance sheet are guided by specific international financial reporting standards, it would be most likely that different auditors would apply identical standards to the various items. The finding therefore implied that high auditor turnover alone was not likely to trigger the earnings management practice. (Loebbecke et al., 1989) found that 36% of the fraud were done in the first two years of an auditor tenure, the risk of audit fail is higher during the initial level of audit assignment than later years.

In order to establish the extent of earnings management practice, the respondents were asked whether their firms' recognised revenue in the period not related to it. The results were as shown in Table 4.9

Table 4.9 Extent of earnings management in listed firms in Kenya

Response	Frequency	Percent
Strongly agree	5	16
Agree	17	53
Not sure	7	22
Disagree	3	9
Total	32	100

Findings in Table 4.9 reveal that earnings management was practiced in 69 percent of the organisations as their respondents indicated that revenues were normally recognised in periods not related to them. Only 9 percent of the respondents disagreed with a further 22 percent indicating that they were not sure.

Globally the practice is prevalent. It was addressed by Alan Greenspan, then the Chairman of the Federal Board in USA, in his semiannual monetary policy report to congress on July 16, 2002, affirmed that “the business community has developed some greed where companies executives looked for ways ‘harvest’ of stock market gains. As a result, of the attractive spread of shareholding and options among corporate managers it negatively created incentives to artificially inflated reported earnings in order to maintain stock prices high and rising. The result indicates that the options were poorly structured and in addition, they failed to suitably arrange the long-term interests of shareholders and those of the managers” the model which is so important for effective corporate governance.

The incentives that were created overcame the rational judgment of most corporate managers. It is not that human beings have become any greedier than the past generations, it is that the opportunity to express greed has grown big. More evidence is from the Enron Case, who was WorldCom CEO. According to the prosecutor Enron was motivated to do fraud when there was pressure on share price. The prosecution further stated that Enron’s personal wealth was based on WorldCom shares and he had borrowed \$ 400 million using those shares as the collateral (Ackman, 2005).

In order to establish which factors were more likely to be responsible for earnings management, descriptive statistics were used to generate the means of the seven statements. The responses were coded where strongly agree was coded as 1, agree was coded as 2, not sure was coded as 3, disagree was coded as 4 while strongly disagree was coded as 5. The means of the responses were then ranked from the lowest to the highest shown in Table 4.10.

Table 4.10 Ranking of the factors influencing earnings management practice

Statement	N	Min	Max	Mean	Std. Dev.
High shareholders' expectations in terms of high profitability from management	33	1	5	1.82	1.131
Poor financial performance of a company that negatively affects its reputation in the public	33	1	5	2.03	1.015
Management incentives based on company performance induces managers to mis-report financial performance	33	1	5	2.06	1.029
Purposeful possession of the company shares by management with intent to sell them to increase their wealth	33	1	5	2.45	1.252
Weak internal controls systems of the company	33	1	5	2.45	1.277
Management subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures	33	1	5	2.91	1.355
High external auditor turnover, changing auditors after every 1 or 2 years	33	1	5	3.24	1.146

Findings in Table 4.10 indicate that three of the seven statements were the most responsible for the earnings management practice within the listed firms in Kenya. These are; High shareholders' expectations in terms of high profitability from management; Poor financial performance of a company that negatively affects its reputation in the public; and Management incentives based on company performance induces managers to mis-report financial performance. The three had a mean of less than 2 (agree).

The findings further indicate that the respondents were not sure of the likelihood of four out of the seven statements being able to encourage earnings management practice. These are; Purposeful possession of the company shares by management with intent to sell them to increase their wealth, Weak internal controls systems of the company, Management subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures; and High external auditor turnover. The four had their means at 3 (not sure)

These findings imply that the most likely factors responsible for earnings management practice in listed firms in Kenya are High shareholders' expectations in terms of high profitability from management; Poor financial performance of a company that negatively affects its reputation in the public; and Management incentives based on company performance induces managers to mis-report financial performance.

In order to establish the relationship between the factors influencing earnings management practice in Kenyan firms, multiple regression techniques were employed. The responses on earnings management were adopted as the dependent variable while the seven factors discussed under tables 4.2 to 4.8 were taken as the independent variables. The multiple regression equation is given as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \varepsilon$$

Where:

$$EM = \alpha + \beta_1 I + \beta_2 W + \beta_3 PFC + \beta_4 SE + \beta_5 CG + \beta_6 AR + \beta_7 AC + \varepsilon$$

Where:

EM	=	Earnings Management.
I	=	Incentives.
W	=	Wealth Increase.
FC	=	Financial Condition.
SE	=	Shareholders Expectation.
CG	=	Company Growth.
AR	=	Accounts receivable/Inventory.
AC	=	Auditors Changes.
ε	=	Error term

Table 4.11 Multiple regression results on earnings management.

SUMMARY OUTPUT

Regression Statistics

Multiple R

0.55431

R Square

0.307259

Adjusted R Square

0.113292

Standard Error

0.781851

Observations

33

ANOVA

df

SS

MS

F

Significance F

Regression

7

6.778325

0.968332153

1.584076607

0.186199

Residual

25

15.28228

0.61129124

Total

32

22.06061

Coefficients

Standard Error

t Stat

P-value

Lower 95%

Upper 95%

Lower 95.0%

Upper 95.0%

Intercept

3.000807

0.520667

5.763389908

5.25075E-06

1.928473

4.07314

1.928473

4.07314

mgt_incentives

-0.22359

0.175369

-1.2749377

0.214053396

-0.58476

0.137595

-0.58476

0.137595

shares

-0.24813

0.119529

-2.07592072

0.048337944

-0.49431

-0.00196

-0.49431

-0.00196

poor_performance

0.344899

0.173088

1.992625661

0.057327588

-0.01158

0.701379

-0.01158

0.701379

Shareholders exp.

-0.05015

0.157267

-0.31890922

0.752444648

-0.37405

0.273744

-0.37405

0.273744

internal_controls

-0.13449

0.139362

-0.96503226

0.343771628

-0.42151

0.152533

-0.42151

0.152533

accounts_receivables

0.057007

0.132336

0.43077567

0.670322871

-0.21554

0.329559

-0.21554

0.329559

auditors

-0.04114

0.158037

-0.26032966

0.796741724

-0.36662

0.284342

-0.36662

0.284342

As seen from Table 4.11, the multiple regressions for incentives management were established as:

$$E M = 3.0081 - 0.22359 I - 0.24813W + 0.344899 PFC - 0.05015 SE - 0.13449CG + 0.057007AR - 0.04114 AC + \varepsilon$$

The regression yielded a coefficient of determinant (R^2) of 0.31 suggesting that the explanatory power of the model was only 31%. This established a weak relationship between the dependent and the independent variables suggesting that there are other variables responsible for variations in earnings management other than those identified by this study. This finding implied that some caution is necessary while dealing with the model since the error term accounts for 69% of the variations in the model.

In an open question, the respondents were asked to indicate other ways they thought would achieve earnings management in public listed companies. The responses of the respondents included;

Expectations of shareholders based on industry performance (14%), Pressure for management to show good results (12%), poor accounting systems, that are difficult to understand thereby giving room to alterations (10%), to avoid the issue of profit warning (10%), to prevent theft of company resources from being detected (9%), to avoid payment of heavy taxes (7%), to avoid alienating current investors and new investors (7%), to avoid pressure to yield to workers asking for higher wages (6%), to ensure company sustainability (6%), Lack of qualified senior level team (4%), Motivation of company staff with good results (6%), to increase goodwill of shares performing poorly in the stock exchange (6%), to safeguard management reputation through financial performance (6%), to meet the statutory requirements (6%), to safeguard the Tenure of the head of finance (6%), Poor application of international reporting standards (4%) and Related party transactions (4%).

4.5 Earnings management practice in public listed corporations

The second objective of the study was to establish how earnings management is practiced in public listed corporations. To achieve this, the respondents were required to respond to three statements touching on goodwill, revenue recognition and inventory valuation which the most

critical areas that earnings management is likely to be perpetrated through. Results on the amortization of goodwill were as shown in Table 4.12.

Table 4.12 utilization of goodwill amortization in earnings management

Response	Frequency	Percent
Strongly agree	7	21
Agree	16	49
Not sure	5	15
Disagree	3	9
Strongly disagree	2	6
Total	33	100

According to Table 4.12, 70 percent of the respondents agreed that amortization of goodwill has created an opportunity of accounting manipulation where it either increases or reduces profit. Only 15 percent of the respondents disagreed with this position while another 15 percent were not sure. This finding implied that amortization of goodwill could be one of the tools applied by listed firms in earnings management. A technical issue that arises where the accounting of the acquisition is done is that in many acquisitions, it appears that there is a difference between the price paid for the business and the value of the net assets acquired by the company. The difference is referred to as goodwill. If treated as an asset and amortized, it can have a significant impact on depressing reported profits. The amortization of goodwill created an opportunity for some creative earnings management of either increasing profit if the amortization is of less value or reduce profit if it is high (Catherine and Oriol, 2005).

Results on revenue recognition were as shown in Table 4.13

Table 4.13 utilization of revenue recognition in earnings management

Response	Frequency	Percent
Strongly agree	12	36.5
Agree	12	36.5
Not sure	4	12
Disagree	4	12
Strongly disagree	1	3
Total	33	100

Results in Table 4.13 indicate that 73 percent of the respondents agreed that improper revenue recognition as practiced in listed firms where the management realizes revenue in the wrong accounting period to regulate its sales. Whereas 15 percent of the respondents disagreed with this statement, 12 percent were not sure. This finding implies that revenue recognition could be another tool normally used by listed firms in their earnings management. Revenue should only be recognized when the goods and services are delivered to its customers not before delivery. Improper recognition also involves fictitious sales (Rezaee, 2002).

Results on inventory management were as shown in Table 4.14

Table 4.14 Utilization of inventory management in earnings management

Response	Frequency	Percent
Strongly agree	13	40
Agree	11	33
Not sure	3	9
Disagree	4	12
Strongly disagree	2	6
Total	33	100

Findings in Table 4.14 show that 73 percent of the respondents agreed that inventory misstatement was used in earnings management since it constitutes a significant portion of corporate assets and has different accepted stock valuation methods. Whereas 18 percent of the respondents disagreed with this position, 9 percent were not sure. This finding implies that inventory misstatement could be another tool available and normally used by listed firms in their earnings management practice. Stocks form a significant portion of corporate assets, both in size and proportion to all other assets on the balance sheet. Second, there are numerous accepted stock valuation methods. Third, valuation of stocks becomes difficult due to factors like obsolescence, and the necessity to allocate manufacturing costs of stocks. Fourth, mostly are in different locations which make physical control and counting difficult and complicated. These factors make stocks more affected by the earning management practice (Stephen et al., 2002).

In an open question, the respondents were asked to indicate the other methods they thought listed firms applied in alteration of financial information. Their responses included; Banks entering into buy back deals on bonds (3%) Improper capitalization of expenses to make the company appear profitable (3%) management fraud(3%), investment fraud(3%), vendor scams(3%), overstatement of sales revenue(3%), Movement and transfer of balances(3%)posting or releasing provisions to alter operating costs(3%), Profit repatriations to related parties(3%), Providing more provision to show losses especially where there is abnormal growth(3%), provision for bad debts misstatement (3%), provision for expenses that are work in progress(3%), loan amortization schedules for work not completed, Provisions(3%), Revenue recognition, subjectivity in the impairment of assets figures(3%), and inadequate provisions of specific bad debts(3%).

4.6 Relationship between incentives structures and the practice of earnings management

To achieve the third objective which was to establish the relationship between incentives structures and the practice of earnings management in public listed corporations, two statements were posed to the respondents. The two statements touched on incentive structures and compensation schemes to management and their relationship with alteration of financial information. The respondents were to indicate the extent to which they agreed with the statements.

On whether incentive structures and alteration of financial information were related, the results were as shown in Table 4.15

Table 4.15 Effect of incentive structures on alteration of financial information

Response	Frequency	Percent
Strongly agree	14	43
Agree	11	33
Not sure	2	6
Disagree	2	6
Strongly disagree	4	12
Total	33	100

Findings in Table 4.15 show that 76 percent of the respondent agreed that incentive structures and alteration of financial information were positively related. The higher the management incentives based on performance are, the higher the chances of the earnings management practice. Only 18 percent of the respondents disagreed with this position with another 6 percent being not sure of the relationship. This finding implies that firms with incentive structures to management based on the firm's performance were likely to fall victims of the earnings management practice. Management incentives which are based on company performance can persuade managers to misreport performance. Non-alignment in pay-for-performance systems entices managers to cheat and such lying is so persistent that firms would be better to adopt a linear pay-for-performance system (Merle et al., 2006).

Results on compensation were as shown in Table 4.16

Table 4.16 Effect of compensation on alteration of financial information

Response	Frequency	Percent
Strongly agree	8	24
Agree	12	37
Not sure	4	12
Disagree	6	18
Strongly disagree	3	9
Total	33	100

As shown in Table 4.16, 61 percent of the respondents indicated that the primary reason of alteration of financial records is the compensation paid to management based on financial performance. Whereas 27 percent of the respondents disagreed with this position, 12 percent were not sure of this outcome. The respondents were therefore required to indicate what the other motivating factors were if incentive and compensation structures were not the primary reason for alteration of financial information. The responses included; Complex accounting rules (3%), financially troubled firms opt to alter the reports to avoid alienating investors while attracting new ones and thus minimize chances of getting past their current financial woes(3%), Pleasing shareholders - shareholders are the owner of the company and sometime management may have to alter financial statement especially when the company is not performing to its shareholders expectations (3%), pressure for majority shareholder to deliver a certain dividend is major contributor(3%),pressure from shareholders to give favorable

performance (3%), Put pressure to show a positive report of companies performance progress(3%), pressure from regulatory authorities requirements(6%), and reputation damage coz every listed company wants their shareholders to know that they are working for their best of interests(9%). The rise of managers wealth is attached to the stock-based compensation and the resulting equity holdings is the executive compensation (Merle et al., 2006). Share options are not the best way to compensate managers (Jenter, 2001, Aboody and Kaszrik, 2000).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter deals with the summary, conclusions and recommendations of the study. The general objective of the study was to investigate the motivation factors for earning management practice in Kenyan firms: case for public listed corporations.

5.2 Summary of the study

The purpose of this study was to examine the extent to which earning management was practiced in Kenyan public listed corporations. Three research objectives were developed to guide the study from which research questions were drawn to be answered by the study.

The first objective was to establish the motivation behind the practice of earnings management in public listed corporation in Kenya, while the second was to establish how earnings management is practiced in the corporations. The third objective was to establish the relationship between incentives structures and the practice of earnings management in those corporations.

Related literature to earnings management practice was reviewed. Agency Theory and the stakeholder theory were adopted for the study where agency theory is forecasted on the doctrine that individual agents choose actions that maximize their personal utility, while the stakeholder theory articulates that business owed special and specific duties to its investors, and the various stakeholders groups. A conceptual framework was also provided.

Exploratory research design was adopted for the study and all the 56 public listed corporations were considered. The study employed simple random sampling method to get 33 public listed corporations as the representative sample of the entire population. Questionnaires were used to collect the required information. The total number of questionnaires issued and collected was 32 and the return rate was 100% since all the questionnaires issued were returned. The target respondents were staff who worked in the finance department as they best understood the subject at hand and its existence in their respective corporations. Both qualitative and quantitative approaches of data analysis were used for the study.

Quantitative data was tabulated and analyzed through frequencies and descriptive statistics. Quantitative approach of data analysis was to the open ended questions where data was organized into themes corresponding to study objectives. Data were analyzed using the Statistical Package for Social Sciences (SPSS) to process the frequencies and percentages and descriptive statistics which were used to discuss the findings.

5.3 Summary of the findings

On the first objective of the study which was to establish the motivation behind the practice of earnings management in public listed corporation in Kenya. It was established that companies top management incentives that are based on performance were more likely to be involved in earnings management practice as confirmed by 85% of the respondents. This finding concurred with the findings of Merle et al., (2006).

Firms with higher public reputation were more likely to engage in earnings management practice and especially so if negative publicity translated to loss of revenue and profitability to its operations. This was confirmed by 85 percent of the respondents. Again this supports the arguments of Gordon, (1964), that the profitability orientation is directed by the management's own wealth maximization intention. The intention is also defined by job security, which is increased by producing smooth and increased earning streams.

Organizations with policies that allowed their managers to own their shares and to easily trade with them were more likely to be affected by the earnings management practice. The finding concurs with Summers and Sweeney,(1998) that managers may practice earning management to increase the value of their shares and thus increase their wealth.

Organizations that place high shareholders expectations in terms of dividend payout, were more likely to engage in the earnings management practice than those whose shareholders expectations are moderate or low. The findings indicated that 85 percent of the respondents believe that high shareholders expectations from management in terms of high profitability were responsible for the earnings management practice. Gordon (1964), established that there is a general shareholders expectation that management will be in a position to maintain and improve previous level of profitability. If this expectation is not met by actual performance, then a motivation of earning management is established.

Weak internal controls systems could encourage earning management practice within the companies as confirmed by 70 percent of the respondents. Where unethical managers are induced to misstate financial statements. Beasley (1996) established that changes like company structure and poor internal control systems motivates the perpetration of fraud. On the extent of the practice in listed firms in Kenya, it was established that earnings management was practiced in 69 percent of the organisations as their respondents indicated that revenues were normally recognised in periods not related to them.

The second objective of the study was to establish how earnings management is practiced in public listed corporations. It was established that amortization of goodwill was one of the tools applied by listed firms in earnings management as was confirmed by 70 percent of the respondents. Where the accounting of the acquisition, it appears that there is a difference between the price paid for the business and the value of the net assets acquired by the company. This supports the arguments of Catherine and Oriol, (2005) that amortization of goodwill creates opportunities for earning management by either increasing profit if the amortization is of less value or reduce profit if it is high.

Revenue recognition was another tool used by listed firms in their earnings management. This was confirmed by 73 percent of the respondents. Revenue should only be recognized when the goods and services are delivered to its customers and not before delivery. Improper recognition also involves fictitious sales and where the management realizes revenue in the wrong accounting period to regulate its sales.

Inventory misstatement was another tool available and normally used by listed firms in their earnings management practice. This was confirmed by 85 percent of the respondents. There are numerous accepted stock valuation methods while on the other hand valuation of stocks becomes difficult due to factors like obsolescence, and the necessity to allocate manufacturing costs of stocks. Again stocks held in different locations make physical control and counting difficult and complicated consequently making inventory an item more prone to earning management practice.

Other methods used by listed firms to perpetrate earnings management include; Banks entering into buy back deals on bonds (3%), Improper capitalization of expenses to make the company appear profitable (3%), management fraud(3%), investment fraud(3%), vendor scams(3%), overstatement of sales revenue(3%), Movement and transfer of balances(3%), posting or releasing provisions to alter operating costs(3%), Profit repatriations to related parties(3%), Providing more provision to show losses especially where there is abnormal growth(3%), provision for bad debts misstatement (3%), provision for expenses that are work in progress (3%), loan amortization schedules for work not completed, Provisions(3%), Revenue recognition, subjectivity in the impairment of assets figures(3%), and inadequate provisions of specific bad debts(3%).

The third objective was to establish the relationship between incentives structures and the practice of earnings management in public listed corporations, it was established that firms with incentive structures to management based on the firm's performance were likely to fall victims of the earnings management practice. The study further established that the primary reason of alteration of financial records is the compensation paid to management based on financial performance.

the other motivating factors included; Complex accounting rules (3%), financially troubled firms opted to alter the reports to avoid alienating investors while attracting new ones and thus minimize chances of getting past their current financial woes(3%), Pleasing shareholders (shareholders are the owner of the company and sometime management may have to alter financial statement especially when the company is not performing to its shareholders expectations) (3%), pressure for majority shareholder to deliver a certain dividend is major contributor(3%), pressure from shareholders to give favorable performance (3%),Put pressure to show a positive report of companies performance progress(3%), pressure form regulatory authorities requirements(6%), and reputation damage coz every listed company wants their shareholders to know that they are working for their best of interests(9%). Merle et al., (2006). Argue that the rise of managers wealth is attached to the stock-based compensation and the resulting equity holdings is the executive compensation. Jenter, (2001), Aboody and Kaszrik, (2000) further argue that share options are not the best way to compensate managers

5.4 Conclusion

The factors more likely to be responsible for earnings management in public listed corporations in Kenya are; High shareholders' expectations in terms of high profitability from management; Poor financial performance of a company that negatively affects its reputation in the public; and Management incentives based on company performance induces managers to mis-report financial performance. The factors that require further investigations include; Purposeful possession of the company shares by management with intent to sell them to increase their wealth, Weak internal controls systems of the company, Management subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures; and High external auditor turnover.

The relationship between the factors influencing earning management practice in Kenyan firms could be summarised in a multiple regression as:-

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \varepsilon$$

Where:

$$E M = \alpha + \beta_1 I + \beta_2 W + \beta_3 PFC + \beta_4 S E + \beta_5 CG + \beta_6 AR + \beta_7 AC + \varepsilon$$

$$E M = 3.0081 - 0.22359 I - 0.24813W + 0.344899 PFC - 0.05015 SE - 0.13449CG + 0.057007AR - 0.04114 AC + \varepsilon$$

Where:

EM	=	Earnings Management.
I	=	Incentives.
W	=	Wealth Increase.
FC	=	Financial Condition.
SE	=	Shareholders Expectation.
CG	=	Company Growth.
AR	=	Accounts receivable/Inventory.
AC	=	Auditors Changes.
ε	=	Error term

The coefficient of determinant (R^2) was 0.31 suggesting a weak relationship between the dependent and the independent variables suggesting that there are other variables responsible for variations in earnings management other than those identified by this study.

Other ways listed companies could achieve earnings management in public listed companies include; Expectations of shareholders based on industry performance (14%), Pressure for management to show good results(12%), Poor accounting systems, that are difficult to understand thereby giving room to alterations (10%), To avoid the issue of profit warning (10%), To prevent theft of company resources from being detected(9%), To avoid payment of heavy taxes(7%), To avoid alienating current investors and new investors (7%), To avoid pressure to yield to workers asking for higher wages (6%), To ensure company sustainability (6%), Lack of qualified senior level team (4%), Motivation of company staff with good results (6%), To increase goodwill of shares performing poorly in the stock exchange (6%), To safeguard management reputation through financial performance (6%), To meet the statutory requirements (6%), To safeguard the tenure of the head of finance (6%), Poor application of international reporting standards (4%) and Related party transactions (4%).

5.5 Recommendations

Based on the findings of the study it is recommended that:

1. The CMA strengthens its supervision role by providing clear guidelines, policies and regulations to govern management incentives that are based on company performance. The study has established that bonus issues, share options and managers indulgence in share trading induce managers to mis-report financial performance
2. That CMA compels public companies to adopt accounting systems that are easy to understand. The study has established that poor accounting systems that are difficult to understand give room for alterations of financial information.
3. That the Kenya Revenue Authority engages the public listed companies positively with a view of assisting them manage their tax obligations without jeopardizing their operations. The study has established that tax management was one of the key drivers of earnings management.
4. CMA provides clear guidelines, policies and regulations on related party transactions where listed companies trade with their subsidiaries and parent companies. The study has established that related party transactions were loopholes for earnings management.

5.6 Suggested areas of further research

Based on the findings of the study, the relationship between the factors influencing earning management practice in Kenyan firms could be summarised in a multiple regression as:-

$$E M = 3.0081 - 0.22359 I - 0.24813W + 0.344899 PFC - 0.05015 SE - 0.13449CG + 0.057007AR - 0.04114 AC + \varepsilon$$

Where:

EM	=	Earnings Management.
I	=	Incentives.
W	=	Wealth Increase.
FC	=	Financial Condition.
SE	=	Shareholders Expectation.
CG	=	Company Growth.
AR	=	Accounts receivable/Inventory.
AC	=	Auditors Changes.
ε	=	Error term

The coefficient of determinant (R^2) was 0.31 suggesting a weak relationship between the dependent and the independent variables suggesting that there are other variables responsible for variations in earnings management other than the seven in the regression model. Further research is therefore recommended to establish the other variables that constitute the error term.

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APPENDICES

Appendix I: Letter of Introduction

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Dear Respondent,

I am a Masters of Commerce graduate student at the Strathmore University. I am conducting a study on motivation factors for earning management practice in Kenyan firms, case for public corporations.

The purpose of this letter is to request you to respond to the items of the questionnaires that are attached.

The information provided will be protected by the principle of confidentiality. Your participation is therefore very imperative for the accomplishment of this study and it will be highly appreciated. Should you have any questions or concerns with regards to the questionnaire, please do not hesitate to contact me at any time through my contact provided above.

Thank you for your cooperation and time.

Sincerely,

Onesmus Waiguru

Appendix II: Questionnaire

(This questionnaire is designed to gather information from the accounting officers in all public listed companies in Kenya. It is meant for academic purposes only. Fill it in a genuine manner, your responses will be analysed and be kept in a confidential manner)

PART A: RESPONDENTS

1. Do you work in a Finance department? (Tick inside the box)

[] Yes

[] No

2. What is your designation in that department? (Example account assistant, senior accountant, Finance manager etc)_____

PART B: MOTIVATIONS OF FINANCIAL REPORTS ALTERATION IN KENYA

3. For each of the following factors, kindly indicate through ticking your opinion on motivation of the practice in your institution.

On a scale of 1 – 5, (1) Strongly Agree, (2) Agree, (3) Not Sure, (4) Disagree and (5) strongly disagree, rate the following in terms of motivation of financial reports alteration practice:

FACTORS	1	2	3	4	5
Management incentives based on company performance induces managers to misreport financial performances.					
Management pay package and compensation being lower than the value of his Performance.					
Purposeful possession of the company shares by management with intent to sell them to increase their personal wealth.					
Poor financial performance of a company that negatively affect its reputation in the public.					
High shareholders expectation in terms of high profitability from the management.					
Rapid growth of a company which weakens internal controls systems of the company.					
Management subjective judgment on adjustments of accounts receivable and inventory with no proper accounting procedures.					
High external auditor turnover, changing the auditors after a short stay e.g. after 1 year or 2 years.					

4. Please indicate other motivation (s) of financial reports alteration practice that affects your institution._____

PART C: METHODS OF FINANCIAL REPORTS ALTERATION PRACTICES

5. For each of the following factors, kindly indicate through ticking your opinion on the major methods of financial reports alteration in your institution and below the table you can add more that affect your organisation in your business operations.

On a scale of 1 – 5, (1) Strongly Agree, (2) Agree, (3) Not Sure, (4) Disagree and (5) strongly disagree, rate the following in items

FACTORS	(1)	(2)	(3)	(4)	(5)
Amortisation of goodwill has created an opportunity of accounting manipulation where it either increases or reduces profit.					
Improper revenue recognition where the management realise revenue in the wrong accounting period to increase its sales.					
Inventory misstatement since it constitutes a significant portion of corporate assets and has different accepted stock valuation methods.					

6. Please indicate what other method(s) of alteration of financial information that affect your institution. _____

PART D: RELATIONSHIP BETWEEN INCENTIVES STRUCTURES AND FINANCIAL REPORTS ALTERATION PRACTICES

On a scale of 1 – 5, (1) Strongly Agree, (2) Agree, (3) Not Sure, (4) Disagree and (5) strongly disagree, rate the following in items

FACTOR	(1)	(2)	(3)	(4)	(5)
Incentive structures and the alteration of financial information are related, the higher the management incentives based on company performance the higher the chances of the practice.					
The primary reason of alteration of financial reports is the compensation paid to management based on company financial performance.					

7. If Incentive structure is not the primary reason of increase in the financial report alteration practice in your institution which motivation factor can be the primary reason and why?

On a scale of 1 – 5, (1) Strongly Agree, (2) Agree, (3) Not Sure, (4) Disagree and (5) strongly disagree, rate the following in items

PART E: EARNING MANAGEMENT

FACTORS	(1)	(2)	(3)	(4)	(5)
Do you think in your company there is recognition of revenue in the period not related to it?					

Appendix III

List of Public Listed Companies in Nairobi Stock and Securities Exchange

- | | |
|---|--|
| 1. Eaagads Limited | 31. Athi River Mining Limited |
| 2. Kakuzi Limited | 32. Bamburi Cement Limited |
| 3. Kapchorua Tea Limited | 33. Crown Paints Kenya Limited |
| 4. Limuru Tea Limited Company | 34. East Africa Cables Limited |
| 5. Rea Vipingo Plantations Limited | 35. East Africa Portland cement |
| 6. Sasini Limited | 36. KenGen Limited |
| 7. Williamson Tea Kenya | 37. KenolKobil Limited |
| 8. Car & General Kenya Limited | 38. Kenya Power & Lightning
Company |
| 9. CMC Holding Limited | 39. Total Kenya Limited |
| 10. Marshalls E.A Limited | 40. British American Investment
Limited |
| 11. Sameer Africa Limited | 41. CIC Insurance Group Limited |
| 12. Barclays Bank of Kenya Limited | 42. Jubilee Holdings Limited |
| 13. CFC Stanbic of Kenya Holding
Limited | 43. Kenya Re Corporation Limited |
| 14. Diamond Trust Bank | 44. Liberty Kenya Holdings |
| 15. Equity Bank Limited | 45. Pan Africa Insurance |
| 16. Housing Finance Company
Limited | 46. Centum Investment Company |
| 17. Kenya Commercial Bank Limited | 47. City Trust Limited |
| 18. National Bank of Kenya | 48. Olympia Capital Holdings Limited |
| 19. NIC Bank Limited | 49. Trans-Century Limited |
| 20. Standard Chartered Bank Limited | 50. A. Baumann & Company Limited |
| 21. Co-op Bank of Kenya Limited | 51. B.O.C Kenya |
| 22. Express Limited | 52. BAT Kenya Limited |
| 23. Hutchings Biemer Limited | 53. Carbacid Investments Limited |
| 24. Kenya Airways Limited | 54. East African Breweries Limited |
| 25. Longhorn Kenya | 55. Eveready East Africa Limited |
| 26. Nation Media Group Limited | 56. Kenya Orchards Limited |
| 27. ScanGroup Limited | 57. Mumias Sugar Company |
| 28. Standard Group Limited | 58. Unga Group Limited |
| 29. TPS EA (Serena) Limited | 59. Access Kenya Group Limited |
| 30. Uchumi Supermarket Limited | 60. Safaricom Limited |