2020

Association between executive directors' remuneration and earnings management among banks in Kenya.

Mohamed, Yasmin
Strathmore Business School
Strathmore University

ASSOCIATION BETWEEN EXECUTIVE DIRECTORS' REMUNERATION AND EARNINGS MANAGEMENT AMONG BANKS IN KENYA

YASMIN MOHAMED

101874

A RESEARCH THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF COMMERCE TO STRATHMORE BUSINESS SCHOOL, STRATHMORE UNIVERSITY

OCTOBER 2020

DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis/dissertation (use as appropriate) contains no material previously published or written by another person except where due reference is made in the thesis/dissertation itself.

Yasmin Samir Mohamed

October 27, 2020

Approval

The thesis/dissertation of Yasmin Samir Mohamed was reviewed and approved for examination by the following:

Dr. David Mathuva

Director, Undergraduate Programmes

Strathmore University Business School.

Dr. George Njenga

Executive Dean

Strathmore University Business School.

Dr. Bernard Shibwabo

Director, Office of Graduate Studies

ACKNOWLEDGEMENT

First and foremost, praises and thanks to God for His blessings to successfully complete this thesis. I would like to express my deep and sincere gratitude to my Supervisor, Dr. David Mathuva for providing invaluable guidance and immense support throughout this thesis. I also want to thank Dr. Freshia Mugo – Waweru for her essential instructions and advice that assisted me in my thesis.

My completion of this thesis could not have been accomplished without the support and encouragement of my classmates - Sister Consolata and Judith Were; and my children - Shawn and Shane – thank you for allowing me time away from you to research and write. You deserve a trip to Disneyland! I am extremely grateful to my mother as well - Dorothy Achieng, for her constant prayers and affirmation that everything will be alright.

Finally, to my caring, loving and supportive husband – Erick Odira; my deepest gratitude. Your encouragement when the times got rough are much appreciated and duly noted. My heartfelt thanks.

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ABBREVIATIONS AND ACRONYMS

AEM	Accrual-based Earnings Management
ALLP	Accrued Loan Loss Provision
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
DLLP	Discretionary Loan Loss Provision
EC	Executive Compensation
EM	Earnings Management
GAAP	Generally Accepted Accounting Principles
ICPAK	Institute of Certified Public Accountants of Kenya
IFRS	International Financial Reporting Standards
LLP	Loan Loss Provision
OLS	Ordinary Least Square
REM	Real Earnings Management
ROA	Return on Assets

ABSTRACT

This study established the association between executive directors' remuneration and earnings management among banks in Kenya. The research adopted descriptive design. A sample of 34 banks operational over the 12-year period, 2007-2018 was selected. The study used semi-structured questionnaires for primary data collection from a sample of accountants, internal auditors and finance managers operating in banks in Kenya. The study used secondary data from the individual financial statements and annual reports by commercial banks to collect data regarding information related to the total aggregate amount of executive directors' remuneration and the control variables. Discretionary loan loss provision model was used to assess for cases of earnings management from the secondary data retrieved. Both the ordinary least square regression and fixed effects regression models were used. Primary data was analyzed using descriptive statistics and triangulated to observations from secondary data. The results retrieved from both analyses was used for comparison to establish whether there was an agreement or conflict of the findings between the primary and secondary data. The discretionary loan loss provision model found that there was income-increasing and income decreasing discretionary accruals, proxy for earnings management among the banks, which was consistent with the respondents' beliefs. In addition, consistent with the agency theory hypothesis, the study established that there was negative but not statistically significant association between executive compensation and earnings management. However, respondents indicated that stock compensation and bonus payment had a positive impact on earnings management while cash compensation had none. Policy makers and regulators in the industry are encouraged to monitor patterns and trends of earnings management practices for guidelines issuance. Researchers are encouraged to explore other bank specific models of estimating discretionary accruals. One of the limitations was that some of the respondents were reluctant to take part in the study citing policies that prevented them from providing information before obtaining approvals.

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

The need for reliable financial information has driven governments, regulators, investors, businesses and other stakeholders to take a stance to enhance quality of financial reporting which contributes to a reliable and relevant reflection of transactions. Management on the other hand, may continue to manipulate the financial information motivated by several motives. These may be individual motives such as higher incentive programs, or institutional incentives such as tax cuts or stock price increases (Kilic, Acar, & Coskun, 2014). IFRSs and GAAPs that are used to prepare financial statements allow managers flexibilty in exercising their discretion when it comes to choosing accounting methods , applying them and making adjustments over time. Managers can therefore improve the quality of financial statements using their knowledge. When managers however exercise their discretion over accounting processes to influence the level of quality of earnings, earnings management could take place (Nassirzadeh, Salehi, & Alaei, 2012).

Several scholars tried to define earnings management (Healy & Wahlen, 1999; Ronen & Yaari, 2008; El-Diri, 2017). Healy & Wahlen (1999) describe earnings management as when managers use their discretion in financial reporting to adjust financial results to either deceive stakeholders about the compny's performance or control the outcomes of performance-linked contracts. Ronen & Yaari (2008) describe ernings management as all the management behavior that contributes to the failure of management to disclose the real short term, value-maximiszing earnings. El-Diri (2017) provides a definition incorporating the conditions allowing managers to manipulate earnings. He defines earnings management as using management flexibilty on accounting standards to present earnings either upwards or downwards by abusing certain contracting shortcomings, restricted rationaliies and information asymmetries. This study considers earnings management to include all behaviour taken by management to increase or decrease reported earnings as this dimension tends to be consistent with all meanings.

Managers may use two ways to manage earnings. First, the target earnings level may be reached by deviating from the usual business activities. This is referred to as Real Earnings Management

(REM) (Roychowdhury, 2006; Dechow & Skinner, 2000). This way of handling earnings may have a negative impact on the company's potential economic results as the intention is to only improve current period revenues, which may have adverse effects on future cashflows, leading to weak performance afterwards. Second, we have Accrual-based Earnings Management (AEM) that allows managers to exploit recorded earnings while booking accruals for events requiring flecibility in accounting standards (Healy & Wahlen, 1999). Further, the AEM is classified into; non-discretionary and discretionary accruals. Non-discretionary accruals denote the expenditure that a firm is obligated to pay but has yet to pay while discretionary accruals are costs that the firm is not obligated to pay but contemplates them to have been sustained. Non-discretionary accruals simply entail accruals from activities that are made in the present accounting year which are normal for the company owing to its performance level (Ronen & Yaari, 2008). On the other hand, discretionary accruals involve careful selection of accounting treatments with an aim to manipulate earnings. The employment of discretionary accruals as proxies for the management of earnings is very common since the board of directors utilizes it to manipulate earnings, Kam, (2010).

(McNichols, 2000) provided an overview of three different approaches to test for earnings management using discretionary accruals; First, total accruals can be used as a proxy for estimating managerial discretion on earnings. The approach seeks to identify total accruals and hypothesized explanatory factors. Examples of models that used this approach include the Healy model (1985) and Jones model (1991). The second approach to test for earnings management is using specific accruals model that often focuses on a specific industry. In accounting literature, the focus of empirical studies on earnings management by banks is on loan loss provisions (LLPs). Loan loss provisions (LLPs) are a relatively large accrual for commercial banks and therefore have a significant impact on earnings and regulatory capital of banks. The purpose of these provisions is to adjust banks' loan loss reserves to reflect expected future losses on their loan portfolios. Examples of specific accrual studies include (Beatty & Liao, 2014; Beaver & Engel, 1996; (McNichols & Wilson, 1988). The third approach is to observe the behavior of accruals around a specific benchmark through statistical properties of earnings to identify behavior that influences earnings. Considering the nature of the research, the specific accrual approach is ideally suited for my research. This is because I'm concentrating on a particular sector which is distinguished by accruals unique to the sector.

The last two (2) decades have seen the collapse of large companies because of misleading financial reporting practices that intensely mask the truth about the company in order to bluff its stakeholders (Huizinga & Laeven, 2012). Large corporations like Enron, WorldCom, Global Crossing and Adelphia (Moncarz, Moncarz, Cabello, & Moncarz, 2006), (Thornburgh, 2004), (Gómez, 2008), (Barlaup, Drønen, & Stuart, 2009) have collapsed after fabricated financial statements were released which were deceptive (Mohamed & Handley-Schachler, 2015) Consequently, it has adversely affected the confidence of investors regarding relying on information provided in financial reports (Mohamed & Handley-Schachler, 2015). Besides heavy losses of investors' wealth, social and psychological costs can be incurred through manipulation of earnings (Krambia-Kapardis, 2002)

In addition to being practiced in developed nations, the practice of earnings management is prevalent not only on a global scale, but also in Asia and other emerging markets. Satyam Computers Services Limited under reported its liabilities, overstated assets, included fictitious loans and cash balances and also overstated income to meet analyst expectations (Bhasin, 2013). Companies in India have become known for practicing earnings management for various reasons such as performance-based bonuses, personal management benefit, and meeting other earnings targets. Growth factors include flexibility in Indian regulatory bodies, vague lines that can distinguish between fraud and earnings manipulation, poor market competition, knowledge asymmetry, lack of awareness among investors about accounting principles among others (Gill, Biger, Mand, & Mathur, 2013).

In the African continent, for example, in Nigeria, there has been an outcry that more needs to be done to control the markets as accountants and auditors are continually moving beyond the acceptable limits in the accounting profession (Ijeoma, 2014). Afri-Bank was indicted for fraudulent and account manipulations, these cases have given full attention to the auditing profession in Nigeria (Christian, 2017). The continent has witnessed its own version of the Enron fiasco through the Cadbury PLC saga, in which the company's top executives participated in doctoring accounts in an attempt to cover up other shortcomings and other unscrupulous transactions (Leyira & Okeoma, 2014).

In Kenya, The Capital Markets Authority (CMA) took executive action against the board of directors of National Bank (NBK) and the senior management team who provided their services to the bank at 31st December 2015 for purportedly manipulating financial statements and embezzling the bank's funds (Capital Markets Authority, 2018). Additionally, in late 2015 amid the collapse of Imperial bank that led it to receivership, the directors of the bank were indicted for manipulating the bank's reported earnings and using fictitious accounts to expedite transactions for their personal gains from those accounts (Fayo, 2018). At the time Kenya Deposit Insurance Corporation (KDIC) took over Imperial bank, the bank had approximately 53,000 customers with deposit valued at KES 58 billion (CBK, 2016). Chase Bank had an aggregate market value of KES 142 billion in assets as of December 2015. The shareholders' equity was also estimated at KES 11.9 billion (CBK, 2016). The bank was placed under receivership by CBK in 2016. Insider loans stood at KES 13.62 billion compared to the KES 5.72 billion it reported. This showed that the directors manipulated the banks' financial accounts.

Furthermore, in the year 2012 CMC Motors board members were adversely indicted for enhancing the reported earnings of the firm by cataloguing undelivered vehicle sales as revenues and failing to capture interest payments for vehicles sold on credit (Herbling, 2014). Moreover, the near collapse of Uchumi supermarket was linked to misrepresentation of the firm's financial statements accumulating to a figure of KES 1.04 billion to the year 2014 (Cytonn Investments, 2016). Consequently, the near collapse of Uchumi due to alleged earnings manipulation decreased the ownership of the shareholders from 52% to less than 20% forcing the company to be declared insolvent (Ruparelia & Njuguna, 2016).

Following the financial crisis in 2007-2008, there has been much debate in the banking sector on the issue of executive compensation and earnings management reflecting concerns regarding fraudulent activities and accounting scandals (Uygur, 2013). Causes of financial crisis include not only excess liquidity due to low interest rates and the reckless trading of derivatives to exploit asset bubbles, but also corporate governance, including remuneration schemes. Compensation for managers of financial companies has concentrated on short term results to provide rewards, leading to risk underestimation of derivatives or riskier investments (Bebchuk, 2010). The Institute of International Finance supports the fact that the compensation systems plays a significant role in the risk-taking of banks (Institute of International Finance, 2009) as 98% of the major international

banks it surveyed agreed that compensation agreements were a factor in the financial crisis of 2007-2008. Moreover, incentive compensation may have an effect not only on the risk-taking activities of banks but also on the management of their earnings. Accounting decisions impact financial results, and compensation is determined as a result of the success of the management, therefore, management have incentives to make use of the of accounting decisions to optimize compensation. Management incentives for earnings vary depending on how accounting earnings are reflected in the incentive compensation. Hence, this study aims to establish the association between executive compensation and earnings management among banks in Kenya.

The idea that financial managers exploit accounting earnings is commonly acknowledged by users of accounts and is backed by comprehensive literature (Subramanyam, 1996) and (Healy & Wahlen, 1999). Several previous studies endorse the use discretionary accruals and adjustments in accounting to manage earnings (DeAngelo, 1986), (DeAngelo, 1988) & (McNichols & Wilson, 1988). (Sigler, 2011) contended that compensating the board of directors with stock may not really make them to perform well for the benefit of the company to attain its set goals. On the other hand, stock-based compensation can provide the board of directors and the senior managers the incentive to manipulate the firm's financial statements (Faulkender, Kadyrzhanova, Prabhala, & Senbet, 2010), (Haß, Tarsalewska, & Zhan, 2015) in order to enhance their personal wealth at the shareholders' expense even if the firm is not performing well. This was backed up by a survey done by Ernst & Young who established that the top management is more eager on manipulating reported earnings in order to maximize their personal bonuses (Ernst & Young, 2015). Furthermore, most of the managers agreed that they can manipulate the financial reports of their companies due to intense pressure from the shareholders to deliver good financial performance (Ernst & Young, 2015).

Generally, in recent times the pay levels of board members and senior managers have been inflating exponentially regardless of their performances which have been an area of concern (Sheikh & Wang, 2012). Attempts to manage the directors' compensation originally started with the employment of (Greenbury, 1995) in the United Kingdom and the Sarbanes-Oxley Act by the United States of America (USA) as a response for prime corporate scandals like Enron and WorldCom that were associated with excess directors' remuneration (Pokrashenko, 2012). Even with such attempts to control the excess directors' remuneration tied on performance succeeding

studies have indicated that nothing substantial has been done to control the board's compensation since they are still rewarded excess remuneration that consequently led to manipulation of reported earnings (Faulkender et al., 2010), (Choo & Tan, 2012), (Kim, Roden, & Cox, 2013) & (Haß et al., 2015).

There is need for limiting or controlling excess directors' remuneration tied on performance in order to discourage the manipulation of earnings. Though studies had been conducted in different sectors or geographical regions to establish if the excess directors' remuneration leads to manipulation of earnings considering that some studies (Ruparelia & Njuguna, 2016), (Müller, 2014), (Miyienda, Oirere, & Miyogo, 2012) & (Yatim, 2010) have conversely established that director's compensation enhances financial performance. Hence if studies establish that the board's excess compensation positively influences earnings manipulation, the studies can recommend to the government and policy formulators to develop a framework that limits or controls excess directors' compensation which can discourage the directors from manipulating reported earnings for personal gains.

Currently a lot of literature have pointed out that inappropriately aligned remuneration schemes such as; bonuses, stock and stock options compromise the capacity of directors to give an objective oversight role to the stakeholders of a company (Archambeault, Dezoort, & Hermanson, 2008), (Boumosleh, 2009), (Bebchuk, Grinstein, & Peyer, 2010), (Cullinan, Du, & Wright, 2008), (Bierstaker, Cohen, DeZoort, & Hermanson, 2012) & (Hamdani & Kraakman, 2007). Furthermore, various studies conducted in different geographical set-ups have shown that stock-based executive remuneration has a positive relationship with earnings management (Ling, 2016; Burns & Kedia, 2006; Boumosleh, 2009; Armstrong, Larcker, Ormazabal, & Taylor, 2013; Jiang, Petroni, & Wang, 2010; Feng, Ge, Luo, & Shevlin, 2011; Bergstresser & Philippon, 2006; Hass, Tarsalewska, & Zhan, 2016). In contrast, several studies have revealed that there is no connection between directors stock-based remuneration and earnings management (Cullinan et al., 2008; Persons, 2012; Erickson, Hanlon, & Maydew, 2006; Armstrong, Jagolinzer, & Larcker, 2010; & Zhang & Kryzanowski, 2013).

Conversely, in regard to cash compensation, (Persons, 2012) established that there was no substantial association between directors' cash remuneration and the likelihood of financial

restatements. Moreover, (Erickson et al., 2006) revealed that cash compensation decreases the possibility of manipulation of reported earnings. Furthermore, (Crutchley & Minnick, 2012) revealed that a bigger remuneration package for directors mitigates the possibility of lawsuits but excess incentive-based compensation is linked with greater prevalence of lawsuits. Interestingly (Conyon & He, 2016) established that executive compensation had a negative relationship with corporate fraud. The findings agreed with (Ger, 2018) who established a significant negative relationship between executive compensation and real earnings management in Eastern Africa context. Moreover, in regard to bonus payment studies have established that bonuses have no significant effect on the management of earnings (Burns & Kedia, 2006; Harris & Bromiley, 2007).

Although there are several theoretical and empirical research studies on executive directors' remuneration and earnings management, the findings remain inconclusive. Since studies have come up with different findings can be attributed to different variables used, research methodologies employed and equity incentive measures. Furthermore, virtually all the studies have depended on secondary data to answer their research questions.

This study will build on previous studies by assessing the association between the remuneration of executive directors and earnings management among banks in Kenya. It will precisely seek to establish if directors' remuneration significantly influences earnings management. Furthermore it will seek to also use primary data besides secondary data and the results will be analyzed to establish if any differences exists.

1.2 Problem Statement

Earnings manipulation is a technique used by accountants to distort financial information; it has existed for decades but has gained ground more recently because of the controversies that the corporate world has faced. These scandals included the misappropriation of assets by shareholders, doctoring of financial statements, the collusion with auditors to issue unqualified reports. In these cases, investors, in particular, shareholders, were mostly affected and had to bear the consequences. Studying the association between executive compensation and earnings management is relevant because it's the shareholders who lose most often when earnings are distorted and because they use earnings detail to pay management remuneration, they are more likely to be misinformed.

The effect of earnings manipulation has been so profound that it has led to tighter regulation, especially in more developed economies such as the USA, which adopted the Sarbanes-Oxley Act to protect public corporations' investors from fraudulent financial activity (Carter et al., 2005). Such scandals have seen industry giants in Kenya such as National Bank of Kenya, Imperial Bank, Chase Bank, Nakumatt Supermarket, Uchumi Supermaket and Mumias Sugar Company crumble. In response to these corporate scandals, Kenya's Capital Markets Authority took disciplinary action in 2017 against senior management of National Bank of Kenya for misrepresentation of financial statements and siphoning of money from the bank through an embezzlement scheme (Capital Markets Authority, 2018).

Manipulation of reported earnings has severely damaged the firms involved, its stakeholders and the economic system in general (Harris & Bromiley, 2007). (Leng & Ding, 2011) argued that earnings management is usually caused by senior management. (Ling, 2016) postulated that companies have to pay attention to how directors' remuneration like equity pay could impact earnings management and align the compensation package in such a way that it averts earnings manipulation. Consequently, posing a need for a study in Kenya to establish if directors' remuneration provides incentive for earnings manipulation.

Despite the fact that the use of earnings management and its relationship with executive compensation has drawn a significant attention from the academic community, in the previous scientific literature (Cullinan et al., 2008; Harris & Bromiley, 2007; Ger, 2018; Ling, 2016; Burns & Kedia, 2006; Boumosleh, 2009; Armstrong et al., 2013; Jiang et al., 2010; Feng et al., 2011; Bergstresser & Philippon, 2006) it appears that no consensus exists which can be attributed to the models used to measure earnings management. This study makes use of specic accrual method through loan loss provisions of banks to measure earnings management. In addition, there is scarcity of studies that examines executive compensation as motivation for earnings management in the banking industry. To close the gap created by inconsitencies in findings and lack of adequate studies conducted, this study attempted to fill by asking the question, is there an association among banks in Kenya between the remuneration of executive directors' and management of earnings?

1.3 Research Objectives

1.3.1 General Objective

To establish the association between executive directors' remuneration and earnings management among banks in Kenya.

1.3.2 Specific Objectives

1. To establish the extent of earnings management practices in banks in Kenya.
2. To determine the significance of the association between executive directors' remuneration and earnings management in banks in Kenya.
3. To investigate the managerial perspective on the association between the executive directors' remuneration and earnings management in the Kenyan banking sector

1.4 Research Questions

1. What is the extent to which banks in Kenya manage their earnings?
2. Is there a significant association between executive and directors' remuneration and earnings management in banks in Kenya?
3. What is the managerial perspective on the association between the executive directors' remuneration and earnings management in the Kenyan banking sector?

1.5 Scope of the Study

Banks and other financial institutions are frequently exempted from analysis of earnings management research since their financial reporting environments differ from those of other companies; banks operate in a highly regulated environment in an attempt to control risk-taking incentives. They have fundamentally different accrual processes that are not likely to be captured well by total accrual models (Peasnell, Pope, & Young, 2000). In essence, banking literature has adopted a specific approach based on loan loss provisions as they are the most relevant accrual and the discretionary component attached to them is very relevant. It is against this backdrop that this study primarily aims to establish the association between executive directors' remuneration and earnings management in banks operating in Kenya for the period 2007 to 2018 as well as seek

the managerial perspective on the association between the executive directors' remuneration and earnings management.

1.6 Significance of the Study

The study is induced by the desire to comprehend what motivates top management to manipulate reported earnings in banks here in Kenya. The study aims to establish if executive directors' remuneration is the reason why executives manipulate reported earnings or not. The banking sector is one of the Kenyan economy's most diverse and vibrant industries with substantial growth occurring over the last decade. The banking sector is among the top contributors to GDP in the country. The managers and the Board of Directors of banks operating in Kenya will be informed on the association between executive director remuneration and earnings management and how it generally affects growth and performance.

1.6.1 Policy makers and industry regulators

If the findings of the study establish that executive and directors' remuneration positively influences earnings management then the investors, shareholders and the government can be recommended to formulate polices that limits the top executive compensation to cash salary. Since equity incentives, for instance, that are tied to financial performance can motivate the executives and directors to manipulate the financial statements of the firm to continue getting more remuneration even when the firm is performing poorly. The study can enable policy makers and industry regulators such as Kenya's Central Bank to be able to monitor trends and patterns of the practice and consequently issue out regulations and guidelines to the banks.

1.6.2 Researchers and Scholars

The analysis would also be valuable to the prospective researchers interested in conducting studies to establish the association between the executive directors' remuneration and earnings management. Future researchers can use this study to build on their literature and examine a research gap to be bridged. Furthermore, by incorporating primary data for comparison and to supplement the findings of the secondary data analyzed, will encourage future studies to also incorporate primary data since most previous studies relied exclusively on secondary data.

The outcome of the research study will ideally be disseminated via face to face interaction or written feedback through email communication to the study participants written in an executive summary format. In addition, the information may be stored in Strathmore's repository database and can only be accessed upon request.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

The literature review consists of the conceptual review, theoretical models and empirical reviews relevant to the study's objectives. Among the key themes reviewed were the concept of earnings management and executive compensation, agency theory, positive accounting theory and empirical studies based on the main purpose of the research study. The subsequent sections provide a detailed discussion of the reviews.

2.2 The Concept of Earnings Management and Executive Remuneration

Adopting IAS-IFRS as a common and universal accounting language guarantees financial reporting transparency, standardizing national accounting practices and promoting high quality and comparable financial information. Nonetheless, as principle-based guidelines, the IAS-IFRS offers an incentive to manage reported revenues and expenses in order to adjust actual earnings for the period or to consider other intentions, all of which are included under the notion of ‘‘earnings management’’ (Ceccobelli & Giosi, 2019).

Earnings management has been defined in many different ways. According to (Healy & Wahlen, 1999) earnings management occurs when managers use discretion in financial reporting and transction structuring to change financial reports either to mislead stakeholders about the company's underlying economic results or to manipulate contractual outcomes based on the published accounting figures. They further argue that earnings management studies should adopt two critical steps for research designs. First, a study should identify incentives for managers to report. Furthermore, the analysis should measure the impact of managers' use of discretion on unexpected accruals. In other words, the association should be investigated between the managers' incentives and earnings management taking place in banks. According to (Talab, Flayyih, & Ali, 2017), earnings management has been referred to as the manipulation of financial reports with an aim of creating a false impression of the firm's financial performance. On the other hand, (Anh & Linh, 2016) contended that earnings management occurs when executives employ selective accounting practices to adjust financial statements to deceive other stakeholders about the economic performance of the company or to manipulate contractual results linked to the published

accounting numbers. (Kang & Kim, 2011) reasoned that besides making selective accounting choices to manipulate earnings, the board can also manipulate earnings by making operating decisions discretionally.

According to (Matsuura, 2008) earnings management can be classified as accruals earnings management and real earnings management. This research will concentrate on accruals earnings management in addressing its objectives. Accruals earnings management involves cases whereby obligatory expenditure, payroll taxes payable and any forthcoming costs that are yet to be realized but have already been chronicled in the company's financial reports. They represent business transactions that influence potential cashflow even if cash has not changed hands at the moment: hence they represent the time allocation of revenues and expenses with a direct effect only on the profit and loss statement. the Real earnings management, on the other hand, refers to a case whereby there is a deviation from standard business procedures in order to meet short-term earnings targets (Roychowdhury, 2006). This is inspired by board's need to deceive some of the company's stakeholders into believing that in the normal course of business operations certain specific short-term financial reporting goals have been achieved.

Some of the most common techniques of managing earnings includes; changing the method of depreciation from reducing balance technique to a straight-line accounting depreciation framework in order to avoid reporting some costs and re-procuring the company's own shares without reporting the activity in financial statements in order to inflate the company's earnings per share among other approaches (Omar, Rahman, Danbatta, & Sulaiman, 2014). (Md.Musfiqur, Mohammad, & Md.Jamil, 2013) contended that the main reasons that drives the board of directors to manipulate earnings includes incentives to signal or conceal private information, management bonuses motivation, political motivations among others.

Accruals earnings management studies on the non-financial industry have adopted an aggregated approach, based on the calculation of the total amount of accruals, as the difference between cashflow and earnings. The model adopted by (Jones, 1991) and its modified version by (Dechow, Sloan, & Sweeney, 1995) is the most common empirical approach used to test accruals earnings management. On the contrary, banking literature has essentially adopted a specific approach, focusing on a specific item, that is, loan loss provisions, and the level of its discretionary amount

since traditional banks based their business on credit intermediation and have substantial latitude in determining the number of provisions, which is the bank's main accrual. Previous studies; (Beatty & Liao, 2014), (Beatty, Ke, & Petroni, 2002), (Cheng & Warfield, 2005), (Cohen, Cornett, Marcus, & Tehranian, 2014), (Cornett, McNutt, & Tehranian, 2009) used the Discretionary Loan Loss Provision (DLLP) model to measure bank earnings management.

There are three common compensation packages awarded to executives and directors, namely; cash compensation, stock-based compensation and bonus-payments (Kim et al., 2013), (Ling, 2016), (Persons, 2012). Cash compensation is awarded based on the director' performance based on his or her professional skills, experience, commitment and range of rate comparable to other firms. On the other hand, bonus payments are tied in a way that reflects the financial success of the company based on set targets (financial yardsticks such as profits and cash flows) to inspire the directors to perform well in achieving the goals of the company. Finally, stock-based compensation is whereby a company offers stock options to its directors to procure a stipulated number of shares in the firm. Hence when the share price of the firm increases based on a good financial performance then the directors are guaranteed to get desirable stock returns as a reward for a job well done.

In the context of this study, the research investigation seeks to establish if executive directors' remuneration (cash, bonus payment and stock-based compensation) motivates the executive directors to manipulate reported earnings to continue earning more returns.

2.3 Theoretical Review

In literature, there are quite several theories suggested that facilitate the perception of earnings management. This research is driven by the propositions of the Agency Theory and the Positive Accounting Theory. The agency theory implies that management, as shareholder agents are driven by self-interest to maximize their own welfare at the detriment of shareholders, who are the principal in this relationship. Thus, to balance the management's interests with the shareholders' interests, owners should base executive compensation in line with the management's performance. The Hypothesis of Positive Accounting Theory bonus plan suggests that when managers' bonus compensation is linked to a company's financial output, they would choose certain accounting methods and procedures that will ultimately improve the declared profit in that financial year,

when all other factors held constant. Earnings management practices can manipulate reported earnings to the targeted levels, thus participating in Earnings management practices is common for managers to fulfill their self-interest. These hypotheses are discussed in more detail below:

2.3.1 Agency Theory

The theoretical model was developed by (Jensen & Meckling, 1976). The theory postulates the principal-agent association whereby it has been theorized that the managers (agents) are obligated to act for the benefit of the principal's (owners of the organization) which is shareholder's wealth maximization. The primary assumption of the theoretical model postulates agents as selfish opportunists who use available opportunities to exploit their principals (Miller & Whitford, 2007) as knowledge asymmetry exists between the managers (agent) and the shareholders (principal) (Parker et al., 2018). This is because the management of the firm have adequate internal knowledge and prospects of the firm than the owners of the firm and they use this weakness to cater for their own personal interests rather than that of the shareholders (Bosse & Philips, 2016).

Individuals in an agency relationship have their own individual desires and ambitions, and will take advantage of any possible opportunity to improve their well-being. Accordingly, agents may not always work to maximize the welfare of their principal but their own. In cases where information flows imperfectly, certain problems will arise. The agent may work in contravention of the contract's objectives or the agent my not put his best efforts into his work. Thereafter, conflicts of interest exist between principal and agent and the principal is required to incur agency costs in order to minimize the agency problem (Fontrodona & Sison, 2006).

The theoretical model suggests that in order to align the interests of the management with that of the shareholders then the owners should base executive compensation in line with the performance of the management (Gayle, Li, & Miller, 2018). The findings of most studies (Armstrong et al., 2013; Bergstresser & Philippon, 2006; Burns & Kedia, 2006; Boumosleh, 2009; Jiang et al., 2010; Feng et al., 2011; Kim, Roden, & Cox, 2013; Hass, Tarsalewska, & Zhan, 2016; Ling, 2016) that sought to establish the influence of executive compensation on earnings management have been inconsistent with this proposition of the theoretical model. This is because when compensation is tied on performance of the firm and it is not performing well it forces the management to manipulate earnings and conceal poor performance with an aim to continue earning their wages

(Kim et al., 2013). (Yasser & Soliman, 2018) also contended that the management compensation tied to financial performance of the firm motivates the management to manipulate reported earnings.

Conversely, (Ger, 2018) established a significant negative relationship between executive compensation and real earnings management. The findings of the study agreed with the proposition of the agency theory that compensation tied on the financial performance aligns the executive directors' interests with those of the shareholders. This is because according to the agency theoretical model the shareholders should employ optimal contracts with executives whose remuneration should be tied on the financial performance of the firm to ensure the convergence of interests and mitigate agency problems.

Criticisms about agency theory is pinned on the the work of (Brennan, 1994). Brennan discredits the use of incentives for executive compensation and for use in society in general. In his argument, economics interpret rational actions as self-interested but this statement is wrong both in a positive sense, that is, people are not behaving this way, and in a normative sense because if they were behaving in a self-interested manner, the world would be more cruel and an undesirable place. However, this does not provide support for the call for suppression of incentives. Similarly, (Lane, Cannella, & Lubatkin, 1998) indicates that the predictions of agency theory are unsupported in instances where mangement priorities are not in direct conflict with stakeholders' interests. (Boyd, 1995) concludes that recent research has shown that the agency assumptions only suit particular transactions and may be conditional on competitive factors.

This study just like the past studies (Armstrong et al., 2013; Bergstresser & Philippon, 2006; Burns & Kedia, 2006; Boumosleh, 2009; Jiang et al., 2010; Feng et al., 2011; Kim et al., 2013; Hass et al., 2016; Ling, 2016; Ger, 2018) conducted will seek to test the theoretical assumption that executive compensation tied on performance aligns the interests of the directors (agents) with those of the shareholders (principal). The theory informs the dependent variable (earnings management) of the study which is an agency cost. Since earnings management is a form of earnings manipulation whereby the management seeks to conceal poor performance from the shareholders to continue earning more compensation tied on performance.

The agency theory posits that when shareholders develop optimal contracts with executives where the compensation package of executives is linked to the interests of shareholders, there is a greater likelihood of interest union and decreased agency problems. Therefore, the higher the pay, the less opportunistic the executive would be, and the less likely the executive would be tempted to exploit the performance of the company or infringe contracts that bind them to shareholders to fulfill their own interests (Hassen, 2014). This theory therefore posits a negative relationship between executive compensation and earnings management.

Consequently, the study seeks to establish if there is a positive or negative association between executive directors' remuneration and earnings management to conflict or uphold the agency theoretical proposition. Consistent with this theory, the results of the study established a negative relationship between executive compensation and earnings management which confirms to the theoretical hypothesis that executive interests are aligned with shareholders' interests. Thus, with higher salary, the executive will be less opportunistic, decreasing his ability to manipulate the performance of the business results and altering the contract which binds shareholders.

2.3.2 Positive Accounting Theory

The theoretical model was founded by (Watts & Zimmerman, 1978). The authors seek to understand why certain businesses choose to use certain accounting standards and procedures. The theory also aims to provide a forecast of approaches used by other companies. However, it does not recommend what accounting procedures a company should use. The theory suggests that the real selection of accounting standards made in an economic environment will solely be based on self-interest (Watts & Zimmerman, 1986). For example, an agency relationship exists between managers and the company's various stakeholders such as shareholders and debt holders. The stakeholders are only after ensuring that their wealth-related stake in the company is protected. The positive accounting theory therefore aims to predict the accounting approaches implemented by certain companies when considering the effect of these accounting practices on stakeholders' wealth.

The positive accounting theory encompasses three hypotheses which comprise of the debt equity hypothesis, the bonus plan hypothesis and the political cost hypothesis (Ger, 2018). Through these theories, (Watts & Zimmerman, 1978) try to clarify and then predict whether a company could use

a specific method of accounting or whether it would oppose that particular method. Each of these theories reflects numerous opportunities that could explain earnings management practices. The bonus plan hypothesis which is relevant to this study contends that when managers' bonus is tied on the financial performance of a company, then they will select those accounting methods and practices that will subsequently enhance the reported income in that financial year, when all other factors held constant. Managers are opportunists and would take advantage of every opportunity to increase their own benefit in the form of wealth maximization. They will then choose to use that particular accounting method or practice if they believe that a particular accounting method or practice will increase the reported earnings (Salah, 2010). This theory proposes a positive relationship between executive compensation and earnings management.

Since its inception, the Positive Accounting theory has been the subject of numerous criticisms. (Deegan & Unerman, 2006) state that the theory needs to prescribe, not just explain and predict. Furthermore, they contend that the positive accounting theory is scientifically flawed. Another criticism of the positive accounting theory is the fact that it has not been developed since 1970's and this restricts the potential attainments of this theory. Despite the criticism, the Positive Accounting Theory is widely used by many researchers. In the case of this thesis the most suitable accounting theory approach for doing this research is the Positive Accounting Theory. To elaborate on that, the fact that there are existing models that could measure earnings management combined with the assumptions about the constraining effect of the level of executive compensation on the latter, could identify the association between the variables reflecting the executive compensation on the level of earnings management.

Studies reviewed so far (Burns & Kedia, 2006; Erickson et al., 2006; Harris & Bromiley, 2007) have shown that there is no significant relationship between bonus payment and earnings management. This means that the management are not motivated by bonus payments linked to performance to commit earnings management in order to increase their wages. Hence conflicting with the proposition of positive accounting theory. Conversely studies such as (Armstrong et al., 2013; Bergstresser & Philippon, 2006; Burns & Kedia, 2006; Boumosleh, 2009; Jiang et al., 2010; Feng et al., 2011; Kim et al., 2013; Hass et al., 2016; Ling, 2016) established a positive relationship between equity based remuneration and earnings management. This means that when executive compensation is tied on equity the managers will always be motivated to manipulate the reported

earnings with the available accounting standards inorder to increase their remuneration hence conforming with the proposition of the theoretical model.

They hypothesis has been used in this research to describe the opportunistic actions of executives and why they can prefer to use certain accounting methods. The theory is linked to this study because it informed the dependent variable (earnings management) as a technique that management might employ to increase their compensation (independent variable) towards the fulfilment of their own self-interest .The study results indicate negative insignificant association between executive compensation and accrual-based earnings management indicating that the management is not influenced by performance-related incentives to commit earnings management to increase their wealth. The results are inconsistent with the bonus plan hypothesis.

2.4 Empirical Review

This section presents studies that sought to establish the association between executive compensation and earnings management. Research conducted in this area has shown various inconsistencies which may be explained by variations based on the variables (equity, cash and bonus compensation systems) utilized, the context of the studies and methodologies employed. Hence, this section highlights the various inconsistencies presented in empirical findings.

2.4.1 Earnings Management in Banks

There has been quite some research conducted on earnings management by banks using the loan loss provision. It was concluded in early studies by (Greenawalt & Sinkey, 1988) and (Ma, 1988) that banks were using Loan Loss Provisions (LLPs) as long-term mechanisms to smooth earnings. Total LLPs were used as the dependent variable in these studies. (Greenawalt & Sinkey, 1988) concentrated on LLPs behaviour as a function of bank's income and other market condition measures that are likely to affect the quality of loan portfoilios. (Ma, 1988) showed that LLPs are not in fact strongly related to the actual quality of loan portfolios, but the management tends to increase LLPs during periods of high operating income and vice versa. Studies that followed divided LLPs into discretionary and non-discretionary components and focused on the discretionary components as an instrument for earnings management. Nonetheless, there is disagreement on the extent to which this is used for earnings management.

(Collins, Shackelford, & Wahlen, 1995) noted that banks were using LLPs as a tool for earnings management. They pursued a bank-by-bank approach and found that about two-thirds of the banks used LLPs for income smoothing purposes in their survey of 160 U.S. banks. (Bhat, 1996) also concludes that there is a strong relationship between LLPs and earnings for his sample of U.S. banks. He finds that banks that are characterized by low growth, low book-to-asset ratios, high loans-to-deposit ratios, high debt-to-asset ratios, low return on assets, high loan loss provisions-to-gross loans ratios and low assets are likely to smooth earnings.

There are also studies which find evidence that banks do not use LLPs as an earnings management/income smoothing tool. These studies are (Wetmore & Brick, 1994; Ahmed, Takeda, & Thomas, 1999). (Wetmore & Brick, 1994) note that bank managers consider historical credit risk, deterioration in loan quality, foreign risk and economic circumstances when assessing LLPs, and do not consider off-balance sheet exposure or changes in loan composition. However, they note that the lack of income smoothing could be due to circumstances in their sample period, namely the debt crisis of the less developed country, as loan provisions were high due to this crisis for this period. (Ahmed, Takeda, & Thomas, 1999) found that earnings management is not an essential driver of loan loss provisions, but that provisions on loan loss represent substantial changes in the expected quality of the loan portfolios of banks.

(Wall & Koch, 2000) note that these variations in findings between studies are due to different sample selection and the use of different periods of time being investigated. Nontheless, they conclude that the evidence available clearly suggest that banks have an incentive to use loan loss accounting to help manage reported earnings. (Anandarajan, Hasan, & Lozano-Vivas, 2005) note that, in addition to checking for earnings management using LLPs, some of the studies mentioned here have investigated whether banks used other components of financial statements in together with LLPs. Examples of these are (Beatty, Chamberlain, & Magliolo, 1995) and (Collins, Shackelford, & Wahlen, 1995) who have examined how strategic timing of realized gains and losses were used as tools for earnings management. Overall, (Anandarajan, Hasan, & Lozano-Vivas, 2005) conclude that that the findings of various earnings management studies through LLP manipulation are contradictory.

Recent work by (Cornett, McNutt, & Tehranian, 2009) suggests that the provisions relating to discretionary loan loss are related to earnings management. They note, first, that discretionary LLPs are positively related to the unmatched cashflow returns, capital ratios, and asset size of a bank, for their sample of U.S. bank holding companies. And second, the use of discretionary LLPs to manage earnings is significantly related to the fraction of shares owned by the CEO of the bank, the fraction of shares owned by all executives, the presence of duality between CEO and Chair and the pay for performance sensitivity of the CEO. Based on these findings, I believe that strong evidence exists that LLPs act as a tool for banks' earnings management as recent research seem to find evidence consistent with this.

2.4.2 Earnings Management and Executive Compensation

(Healy & Wahlen, 1999) argued that earnings management studies should take two crucial steps for research designs. First, a study should recognize managers' reporting incentives. Second, the analysis should access the impact on unexpected accruals of managers using discretion. In other words, the association between the managers' incentives and earnings management in their banks should be examined. (Beneish, 2001) lists the sources of managerial incentives for earnings management. Executive compensation agreements are among the major factors listed in the study. The compensation packages earned by managers consist of some items which tie the wealth of the managers to the stock values. In particular, stock options make executives more concerned about the investors' reaction to the financial results. Managers are therefore seeking to hold stock prics up, as stock options are very important portions of their income.

Studies in the literature have been conducted that aim to investigate the association between executive compensation and earnings management in banks. (Joyce, 2002) found a statistically significant association between Loan Loss Provisions (LLPs) and executive compensation which supports the theory that banks LLPs are at least partly manipulated so that bank managers can increase their overall monetary compensation. (Holthausen, Larcker, & Sloan, 1995) find no evidence that executives manipulate earnings downward when earnings fall below the minimum needed to obtain a bonus. This result supports the belief that executives use LLPs accounts to gain maximum benefits for their compensation packages. The literature mostly consists of studies focusing on the bonus aspect of compensation policies (Healy, 1985; Holthausen, Larcker, &

Sloan, 1995; Guidry, Leone, & Rock, 1999) which showed that bonus schemes pegged on earnings serve as a popular basis of rewarding managers. In addition, (Zmijewski & Hagerman, 1981) stated that, when managers' bonus is dependent on the company's profits, the greater the probability of using such accounting techniques that maximize profits so as to obtain higher bonuses. Inconsistent with these findings are (Burns & Kedia, 2006; Erickson et al., 2006; Harris & Bromiley, 2007) which revealed no significant relationship between bonus payment and earnings management. The possible reason could be that bonus payment does not offer directors the motivation to manipulate earnings but to pursue other unrecorded objectives (Harris & Bromiley, 2007).

Recent studies are beginning to disaggregate the executives and focus on their individual impact on their banks' earnings management. For example (Burns & Kedia, 2006) and (Carter, Lynch, & Tuna, 2007) examine CEO's compensation. Following the passing of the Sarbanes-Oxley Act and the recent fraudulent scandals, regulators, the public and researchers became more aware of the fact that CEO's are not alone in making decisions about their businesses. CFO's are also responsible for the companies financial decisions. (Carter, Lynch, & Zechman, 2005) studied the relationship between discretionary accruals and executive compensation differently from others. They examined the effect of CEO's nd CFO's incentives on the earnings management of the firms by taking into account executive bonus compensation.

Subsequent research has moved away from concentrating exclusively on bonus incentive program towards other executive compensation components. (Gao & Shrieves, 2002) identify the various executive compensation components as salary, stock options, restricted stock, bonus and long-term incentive plans. Their research findings on US companies showed that stock options and bonuses are positively related to earnings management. The studies conducted in different countries have shown that executive director's remuneration regarding stock-based compensation has a positive significant relationship with earnings management (Armstrong et al., 2013; Bergstresser & Philippon, 2006; Burns & Kedia, 2006; Boumosleh, 2009; Jiang et al., 2010; Feng et al., 2011; Kim et al., 2013; Hass et al., 2016; Ling, 2016). Some studies have established that even though the stock-based compensation of CFO's was high in firms that manipulates earnings, there was a little variation in pay when compared to CFO's in firms that do not manipulate earnings (Ling, 2016). Furthermore, Jiang et al., (2010) found that earnings management is more sensitive to

CFOs' equity-based payment compared to CEO's equity-based payment. Moreover, some studies which established that stock compensation has a positive association with earnings management also found that earnings management is less likely to occur when, independent members and women are in the board (Kim et al., 2013). The possible reason for the positive association is because, as executive's compensation is tied on stock prices it creates a motivation to manipulate earnings and conceal poor performance with an aim to continue earning the excess remuneration (Kim et al., 2013). Hence the executive can fail to diligently monitor the firm's financial reporting process on behalf of the shareholders (Persons, 2012). In comparison, (Feng et al., 2011) revealed that the motivation behind CFOs commiting earnings management is not because they want to increase their wealth but because of pressure from their Chief Executive Officers (CEOs).

Conversely, some studies have found that there is no association between directors' stock-based compensation and earnings management (Cullinan, Du, & Wright, 2008; Persons, 2012; Erickson et al., 2006; Armstrong et al., 2010; Zhang & Kryzanowski, 2013). This shows that the stock-based payment does not provide the directors the incentive to perpetuate earnings management. The reason could be that the cost of getting caught and being punished is greater than the benefits of committing earnings management (Fischer & Verrecchia, 2000).

In regard to cash compensation, Crutchley & Minnick, (2012) found that a larger cash remuneration package for directors mitigates the possibility of lawsuits. On the other hand (Persons, 2012) established that there was no significant relationship between directors' cash remuneration and the probability of earnings manipulation. Erickson et al., (2006) revealed that cash compensation decreases the possibility of earnings management, hence a negative influence of cash salary on earnings manipulation. Kim et al., (2013) recommended cash salary to be the most successful approach that can deny directors the incentive to manipulate earnings.

(Shuto, 2007) adds to literature by studying earnings management and executive compensation in Japan. They use total cash compensation as proxy for executive compensation (executive salary and bonus). The findings are consistent with previous studies that positively and significantly link discretionary accruals with executive compensation. However, (Gabrielsen, Gramlich, & Plenborg, 2002) on a sample of Danish companies leads to a contradictory finding which indicated a positive but insignificant impact on the extent of earnings management. In addition, (Zhou,

Wang, Zhang, & An, 2018) investigated whether high CFO or CEO compensation follows earnings management practices in Chinese public firms in the private sector and found that accrual-based earnings management does not impact executive compensation. Furthermore, a study by (Spinos, 2013) using U.S data for the period between 2004 and 2009 found that the association between managerial ownership and earnings management at 5% significance level is not significant implying that there is no systematic relationship between these two variables.

There is no consensus on findings from prior studies as they suggest that, there can be a positive relation, a negative relation or no relation between executive compensation and earnings management. A number of issues such as differences in research setting, differences in methodology used in measuring earnings management, differences in the theories used or differences in variables used could explain the inconsistency in results. Some researches such as (Healy, 1985) used the Healy method, (Andersson & Frisk, 2016; Lakhal, Lakhal, & Cheurfi, 2014) used the modified jones model. Therefore, to be sure of the association between earnings management and executive compensation, it is necessary to use other accrual models. This study suggests contributing to the literature body by exploring the association between executive compensation and earnings management by focusing on a bank specific accrual (loan loss provision); a proxy for earnings management, to supplement earlier work.

2.5 Models of Assessing Earnings Management

Reported earnings are a collection of cash flows from operations and accruals. The Generally Accepted Accounting Principles (GAAPs) permits the employment of accruals to alleviate timing hitches and to attain better toning of revenues and expenses when assessing corporate performance over year-long time intervals (Fields, Gupta, Wilkins, & Zhang, 2012). Nevertheless, the major limitation of accrual accounting is that it generates opportunities for manipulating earnings (Dechow & Skinner, 2000). This means that the directors or the senior management can exercise a momentous discretion in determining the size of accruals (Fields et al., 2012). Therefore, they might employ accruals to conceal bad performance or to defer the recognition of income to the future financial years (Fields et al., 2012).

Accruals can be understood as a journal entry whereby a revenue or an expense item is documented in absence of a real cash transaction. There are two classes of accruals namely; non-discretionary

and discretionary accruals. Non-discretionary accruals denote the expenditure that a firm is obligated to pay but has yet to pay while discretionary accruals are costs that the firm is not obligated to pay but contemplates them to have been sustained. Non-discretionary accruals simply entail accruals from activities that are made in the present accounting year which are normal for the company owing to its performance level (Ronen & Yaari, 2008). On the other hand, discretionary accruals involve careful selection of accounting treatments with an aim to manipulate earnings. Consequently, the board of directors directly influences discretionary accruals (Ronen & Yaari, 2008).

(Jones, 1991) indicated that the assessment of earnings management is majorly focused on the employment of discretionary accruals (Beneish, 2001). The employment of discretionary accruals as proxies for the management of earnings is very common since the board of directors utilizes it to manipulate earnings (Kam, 2010). A firm's total accruals can be observed in its financial reports, but discretionary accruals cannot be observed. Therefore, the percentage of accruals that are discretionary and non-discretionary accruals is very difficult to estimate. Consequently, in the context of this study we are interested to detect the discretionary accruals.

(McNichols, 2000) provides an overview of the three different research approaches to test for earnings management using discretionary accruals commonly used in the earnings management literature:

I. The first approach attempts to identify discretionary accruals based on the relationship between total/aggregate accruals and explanatory factors that are hypothesized. Models which use this approach are referred to as total accrual models. Some of the most common models used include:
   a. ***The Healy model (1985);*** Healy was the first to develop such a total accrual model to measure earnings management using discretionary accruals. This model uses the average of the total accruals during an estimation period as a proxy for the non-discretionary accruals, so the discretionary accruals can be determined by the difference between the non-discretionary and total accruals.
   b. ***The DeAngelo model (1986);*** which uses prior year's total accruals as a measure of the non-discretionary accruals for the current year. The discretionary accruals are

determined by the difference between these estimated non-discretionary accruals and the total accruals in the current year.

c. ***The Jones model (1991);*** a regression approach to control for nondiscretionary factors influencing accruals, such as the effects of changes in a firm's economic circumstances, which specifies a linear relation between the total accruals and changes in sales, property, plant and equipment. The residual of this regression is used as a proxy for the discretionary accruals.

d. ***The Modified-Jones model;*** developed by Dechow et al. (1995). This model is based on the Jones model, but the change in revenue is adjusted for changes in receivables in the current year.

II. The second approach to test for earnings management is to model a specific accrual which focuses on specific industry settings (banking, property and casualty insurance). For empirical studies using specific accrual models, the emphasis is always on a particular industry, where a single accrual or a set of accruals is sizeable and requires considerable judgment. Due to this fact, it is likely that management uses discretion on this specific accrual or set of accruals, making it a likely object for earnings management. Similar to the total accrual approach, it is important to identify the non-discretionary component and the discretionary component, in this case within a specific accrual account. Examples of specific accrual studies include (McNichols & Wilson, 1988), (Beaver & Engel, 1996), (Beatty, Ke, & Petroni, 2002), (Beatty & Liao, 2014).

III. The third approach is to observe the behavior of accruals around a specific benchmark. This approach examines statistical properties of earnings to identify behavior that influences earnings. The benchmark that is used in these studies can be for example zero, or a prior quarter's earnings. It is tested whether the incidence of amounts above and below the benchmark are distributed smoothly, or reflect discontinuities due to the use of discretion by management.

Thus, the problem that emerges, though, is what would be the ideal approach to use in determining banks' earnings management? First of all, it's worth noting that banks and other financial institutions are frequently excluded from research studies on earnings management, as their

financial reporting conditions vary from those of industrial companies. They have fundamentally different accrual processes, which are unlikely to be well captured by total accrual models (Peasnell, Pope, & Young, 2000). Considering the nature of the research, the specific accrual approach would be most suitable. This is because I am focusing on a single industry characterized by industry-specific accruals, which is also one of the reasons why banks are typically excluded from studies using total accrual models as previously stated.

The specific accrual approach has its advantages and disadvantages (McNichols, 2000). An advantage is that the researcher may use his or her knowledge of GAAPs to develop an understanding for the key factors influencing the accrual behavior in question. A second advantage is that this approach can be applied in industries where the specific accrual is material and likely to rely on discretion and judgement of management. In addition, the industry-specific setting can also aid in identifying the discretionary component of an accrual by making it easier to see and control variables that need to be taken into account for this. A third advantage is that they produce fairly small estimation errors by using a single account, as opposed to aggregated or total accrual models, where aggregation can lead to errors in parameter estimates.

There are some drawbacks of the approach as well. First, it is necessary that the specific accrual represents the management's use of discretion reliably. In other words, it has to be clear which accrual management can use to manipulate earnings, otherwise the power of the test will be reduced, or a different model need to be used for each specific accrual likely to be manipulated. Another drawback is that bcause only one industry is the subject of the research, the number of firms in the test may be small compared to the number of firms that would be used in an aggregated accruals model, which may have negative consequences on the generalizability of the research findings.

2.5.1 Discretionary Loan Loss Provision Model (DLLP)

Financial institutions, especially banks, function differently from other companies and therefore the factors that contribute to banks' earnings management activities frequently differ from other non-financial companies (Macey & O'Hara, 2003). Therefore, the model required for banks to calculate discretionary accruals must be designed to take into account parameters specific to banks. In the banking industry, discretionary loan loss provisions have been commonly used to calculate

earnings management. The adopted variables originate from a vast majority of prior literature: (Beatty & Liao, 2014), (Beatty, Ke, & Petroni, 2002), (Cheng & Warfield, 2005), (Cohen, Cornett, Marcus, & Tehranian, 2014), (Cornett, McNutt, & Tehranian, 2009) who used the Discretionary Loan Loss Provision (DLLP) model to measure bank earnings management.

As shown below, the absolute residual value resulting from estimating equation represents the degree to which each bank manages its earnings.

$LLP_{it} = \beta_1 \text{Size}_{it} + \beta_2 \Delta\text{Loan Charge-offs}_{it} + \beta_3 \Delta\text{Loans}_{it} + \beta_4 \Delta\text{Non-performing Loans}_{it} + \beta_5 \Delta\text{Non-performing Loans}_{it-1} + \beta_6 \Delta\text{Non-performing Loans}_{it+1} + \varepsilon_i$

Where:

LLP_{it}= total loan loss provision for bank *i* at the year *t*,

Size_{it}=Total Assets

$\Delta\text{Loan Charge-offs}_{it}$=represents the difference in total loan charge-offs between periods *t* and *t-1*

ΔLoans_{it}=represents the difference in total loans between periods *t* and *t-1*

ΔNon-performing Loans=reflects the change in non-performing loans between periods *t* and *t-1*

$\Delta\text{Non-performing Loans}_{it-1}$=reflects the change in non-performing loans between periods *t-1* and *t-2*

$\Delta\text{Non-performing Loans}_{it+1}$= represents the change in non-performing loans between periods *t+1* and *t*

ε_i= The error term represents the unexplained component of the regression and hence is treated as the Discretionary Loan Loss Provisions (DLLP).

All the variables except Size in the above Equation are deflated by the book value of total assets of each bank.

2.5.2 Beaver and Engel (1996) model

The loan loss provision is split into two categories according to (Beaver & Engel, 1996); discretionary and non-discretionary. The rationale is that Loan Loss Provision (LLP) should be calculated over one duration by a number of factors that include nonperforming loans, changes in nonperforming loans, and changes in loans. The portion which these variables can't clarify should be the discretionary part. On these variables the total LLP is regressed, and the fitted values of this model reflect the Nondiscretionary LLPs (NLLPs). The difference between Total LLPs (Model 1) and NLLPs (Model 2) represent the Discretionary LLPs (DLLPs). Their model is set out in the following way:

$$\text{Total LLPs}_{it} = \alpha 0 + \alpha 1 \cdot \text{NPL}_{it-1} + \alpha 2 \cdot \text{CHGNPL}_{it} + \alpha 3 \cdot \text{CHGLOANS}_{it} + \varepsilon_{it} \quad \ldots\ldots\ldots\ldots (1)$$

Where:

Total LLPs$_{it}$ is the provision for loan losses

NPL$_{it-1}$ is the beginning period of nonperforming loans

CHGNPL$_{it}$ is the change in the value of the nonperforming loans

CHGLOANS$_{it}$ is the change in the value of loans.

All of the variables are deflated by the *NPL$_{it-1}$*

The fitted values of Model 2 are the NLLPs:

$$\text{NLLPs}_{it} = \hat{\alpha}0 + \hat{\alpha}1 \cdot \text{NPL}_{it-1} + \hat{\alpha}2 \cdot \text{CHGNPL}_{it} + \hat{\alpha}3 \cdot \text{CHGLOANS}_{it} \quad \ldots\ldots\ldots\ldots (2)$$

Consequently, the earnings detection models have varying significant strengths in detecting earnings manipulations in different countries. This study aims to employ these earnings management models to determine their strengths in detecting earnings management in banks operating in Kenya since limited studies have been conducted in this context to address the research gap since (Ger, 2018) only focused on non-financial firms operating in East Africa Region.

2.6 Summary of Literature Review and Research Gaps

Earnings management is a form of accounts manipulation, where management make use of discretion in selecting accounting standards to deceive stakeholders about the company's underlying results or to manipulate contractual outcomes based on published accounting numbers. Management may have different incentives to get involved in managing earnings. They can manipulate accounts for the benefit of the firm, either to reduce political costs (inducing a transfer of wealth between the business and society) or to reduce capital costs (inducing a transfer of wealth between the business and funds providers). Yet they may also manipulate accounts for their own benefit, increasing their compensation (inducing a transfer of wealth between themselves and the business). Furthermore, earnings management can be measured by the use of specific accrual models, total accrual models and studying the behavior of an accrual around a specific benchmark. In literature, banks' earnings management is studied using a specific large accrual for banks, loan loss provisions. Bank managers have an incentive to smooth earnings through the discretionary part of LLPs. Moreover, prior literature distinguishes earnings management into two categories; the earnings management emanating from real activities manipulation (real earnings management) and earnings management through accruals manipulations (accruals-based earnings management). This research will follow the vast majority of the prior literature concerning earnings management and will employ the accrual-based approach to measure earnings management.

Previous studies show similarities as well as inconsistencies that differentiate them. Differences in the theories used, variables used, context of the study and research methods may explain the inconsistencies. There appears to be a consensus in terms of the theories used, as various researchers have used common theories like the agency theory and the positive accounting theory. In terms of the studies context, numerous researchers conducted their studies in different economic contexts such as U.S, Spain, France, Iran. Kenya etc. In terms of variables used and how they are measured, different researchers have used different measures for executive compensation. In addition, various researchers have used different models in measuring earnings management. This study makes use of bank-specific accrual estimation model through the use of LLPs by banks in order to make comparisons in research findings. Additionally, limited studies have been conducted in the Kenyan context to establish the association between executive directors' remuneration and earnings management among banks in Kenya considering that (Ger, 2018) focused on non-

financial service firms in Eastern Africa. Even though there have been cases where the executive has been responsible for corporate failures in Kenya. It is based on these identified gaps that this study aims at bridging the research gap by conducting a study in the Kenyan banks with an aim to establish if there is an association between executive directors' remuneration and earnings management.

2.7 Conceptual Framework

Figure 2.1 below presents a conceptual framework showing the association between Executive Directors' remuneration (independent variables characterized by cash, bonus and stock-based pay) and earnings management (dependent variable). The association will be moderated by the following control variables (Financial performance, firm's growth, bank size, size of loans, leverage and income diversification).

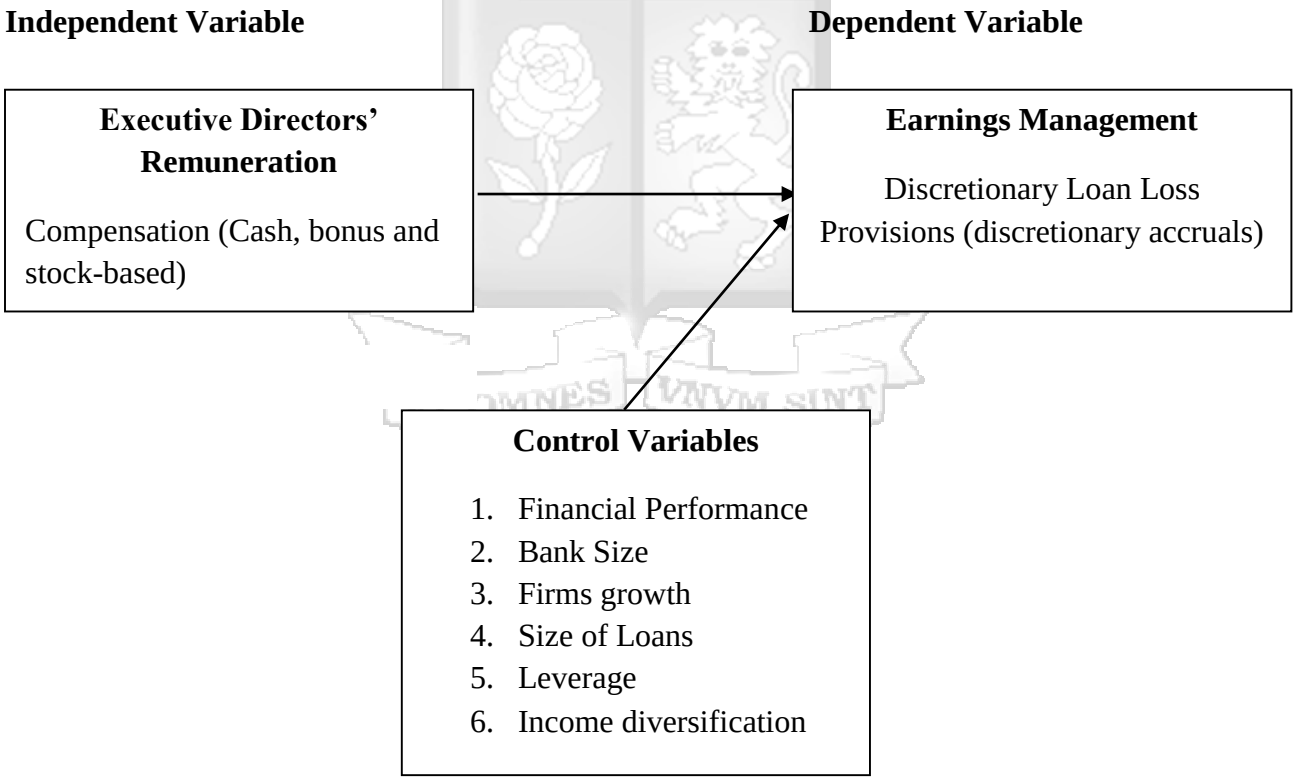

Figure 2.1 Conceptual Framework illustrating Association between Executive Directors' Remuneration and Earnings Management

2.7.1 Executive Compensation

The more an executive has a pay plan that is tied to the bank's value, the more opportunity he or she has to make accrual adjustments, that is, to manage earnings. Executive compensation comprised of the aggregate amount of money paid to Directors' as indicated in the financial reports of the companies as was the case of (Burns & Kedia, 2006), (Crutchley & Minnick, 2012), (Feng et al., 2011), (Zhang & Kryzanowski, 2013).

2.7.2 Earnings Management

Accrual-based earnings management was measured as a portion of discretionary accruals by the various models identified by literature, Discretionary Loan Loss Provision Model (DLLP) and (Beaver & Engel, 1996) Models. The study relied on Loan Loss Provisions as proxies for the earnings management of the banks.

2.7.3 Control Variables

2.7.3.1 Financial Performance

The bank's performance also impacts the bank's executives' discretion about accruals. It is predicted that, if the bank performs badly, accrual adjustments are needed more because the managers are trying to place their banks in a positive light for the public. Financial performance was measured as profit after tax divided by total assets (Return on Assets) in line with earlier work (Njogu, 2016), (Fudenberg & Tirole, 1995) and (Joyce, 2002).

2.7.3.2 Bank Size

This variable was measured by the natural logarithm of the Bank's total assets based on that year consistent with previous studies (Ger, 2018), (Li, 2017), (Lakhal, Lakhal, & Cheurfi, 2014) and (Kanagaretnam, Lobo, & Mathieu, 2003). The effect of this variable on earnings management is unclear. A larger company may have a more structured management program or a stronger capital structure, reducing executives' flexibility over accruals. On the other hand, the executives of large banks can get more benefits from manipulation because of its effects on share prices. (Kanagaretnam, Lobo, & Mathieu, 2003) used the size variable and reported a positive correlation, implying larger banks are pursuing more manipulation of their financial results.

2.7.3.3 Firm's Growth

The growth variable was measured as the change in total liabilities consistent with previous research studies (Collins, Shackelford, & Wahlen, 1995), (Uygur, 2013). (Collins, Shackelford, & Wahlen, 1995) argued that the change in total liabilities should be a good proxy for growth, because banks usually fund more than 90% of their assets with debt.

2.7.3.4 Size of Loans

This relates to the loan amount at the bank divided by total assets. Based on previous research studies (Ahmed, Takeda, & Thomas, 1999; Beatty & Liao, 2011; Fonseca & González, 2008) loan size is one of the variables that might impact Loan Loss Provision (LLP) and was thus included in the control variables.

2.7.3.5 Leverage

Consistent with previous work (Lakhal et al., 2014), (Andersson & Frisk, 2016), (Li, 2017), leverage was used as a control variable in the regression model. The financial leverage relates to a proportion of the assets that will be covered by debt. It was calculated as total debt divided by total assets. According to (Jiang, Petroni, & Wang, 2010) leverage may have differing effects on earnings management. To this extent, they support the notion that management of high leveraged firms have greater incentives to engage in income increasing discretionary accruals to avoid debt covenant violation. In addition, (Beatty & Weber, 2003) indicated that high financial leverage potentially increases income smoothing by using accruals and other accounting choices which increase profit. On the other hand, authors like (Peasnell, Pope, & Young, 2000) present a negative relationship between the absolute value of discretionary accruals and leverage.

2.7.3.6 Income Diversification

As measured by non-interest income divided by total revenue (DeYoung & Rice, 2004), (Stiroh & Rumble, 2006), represented an incentive for banks to grow business, leading to increased bank's ability to maintain their profitability.

2.8 Operationalization of Variables

This section explains how the dependent variable, independent variable and control variables were calculated.

Table 2.1: Operationalization of variables

Variables	**Variables definition**	**Measure of variables**
Dependent variable		
ALLP	Accrued Loan Loss Provision	Discretionary loan loss provision estimated from the residual in Discretionary Loan Loss Provision Model and (Beaver & Engel, 1996)
Independent Variable		
EXECOMP	Executive Compensation	Aggregate compensation paid to Directors
Control Variables		
Financial Performance	Performance	Profit after tax divided by total assets (ROA)
Bank Size	Size	Natural logarithm of the asset size of the bank
Firm's Growth	Growth	Change in total liabilities
Loan Size	Loans	Total loans outstanding divided by total assets
Leverage	Leverage	The total debt divided by total assets
Income Diversification	Income Diversification	Non-interest income divided by total revenue

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

The study employed the following methodological approaches illustrated in the subsequent sections below when addressing its set objectives regarding the research philosophy, research design, sample and sampling techniques, research instruments and data analysis techniques.

3.2 Research Philosophy

This study employed a post-positivist paradigm. Post-positivists contend that research follow a series of logical steps that has to include "multiple perspectives" rather than just dealing with a single reality (Ger, 2018). Post-positivism is a milder form of positivism that follows its doctrines like generation of mean scores to produce generalized objective knowledge but permits more interaction between the researcher and the participants of the study. It employs supplementary techniques such as survey research and qualitative methods like the interviews and observations in obtaining data (Creswell, 2008). Secondary data was obtained from annual reports for information relevant to the variables of this study, additionally primary data was obtained from the targeted participants through questionnaires and the findings were triangulated with that obtained from secondary sources to generate objective and reliable information.

3.3 Research Design

The study adopted a descriptive correlation research design. Correlation research design endeavors to ascertain the existence of relationship between the independent and dependent variable (Leedy & Ormrod, 2012). The design is appropriate for studies where a variation in independent variable impact on dependent variable (Saunders, Lewis, & Thornhill, 2012). Various studies (Conyon & He, 2016), (Persons, 2012), (Armstrong & Vashishtha, 2012) adopted this design because they aimed to establish the association between executive directors' remuneration and earnings management. As defined by (Kothari, 2004), the design requires a methodical and analytical analysis in which the researcher has no influence over the variables of the study as they already exist or are not manipulable. The research design facilitates making inferences related to the study variables, both dependent and independent and enabling valid conclusions to be drawn where

possible, hence the most suitable for the study. A descriptive correlation research design was used to assess the association that exists between the study variables; earnings management and executive compensation.

3.4 Population and Sampling

The total population comprised of 46 Kenyan commercial banks licensed by the Central Bank of Kenya (CBK) based on CBK's bank Supervision Annual Reports for the period 2007-2018 (Appendix V). The unit of analysis was the executive directors of these banks whose remuneration was tied on the financial performance of the firm. These directors comprised of the Managing Directors/Chief Executive Officers and Financial Directors. The respondents of the study comprised of the accountants, internal auditors and the finance managers of the banks. This research did not apply sampling on the basis that the population was small in size. Thus, the research used a census sampling method to cover all 46 Kenyan commercial banks. Census sampling refers to a sampling method whereby all items in a population are enumerated in full. The use of census was recommended by (Saunders et al., 2009) who indicated that census approach increased the quality of the data obtained by eliminating sampling-related errors. The study excluded (4) banks under statutory management, (6) banks which have not been operational for the period under scope as well as (2) existing banks acquired. The exclusion was due to unavailability of data.

Table 3.1: Number of banks included in the sample

Number of banks included in the sample	Number
Total no. of banks over the period 2007-2018	46
Less: Number of banks under statutory management and receivership	(4)
Acquisition of existing banks	(2)
New banks/not operational throughout the period 2007-2018	(6)
Banks included in the sample-295 firm year observations	**34**

3.5 Data Collection Methods

This study used annual reports to collect secondary data and semi-structured questionnaires to retrieve primary data to address its objectives. Most studies (Jiang, Petroni, & Wang, 2010), (Burns

& Kedia, 2006), (Erickson et al., 2006), (Ling, 2016), (Armstrong et al., 2013), (Boumosleh, 2009), (Feng, Ge, Luo, & Shevlin, 2011), (Bergstresser & Philippon, 2006), (Cullinan et al., 2008), (Persons, 2012), (Armstrong, Jagolinzer, & Larcker, 2010), (Zhang & Kryzanowski, 2013), (Hass et al., 2016) exclusively relied on secondary data to address their objectives related to this study. Limited studies have incorporated primary data to supplement the findings from their secondary data except for (Ger, 2018). This study explored both secondary and primary data to assess if a difference exists in the findings and to provide more reliable and objective results.

The study obtained secondary data involving directors' aggregate compensation and items related to accrued-based earnings management from individual bank's annual reports which were available on the bank's websites as well as banking survey and CBK websites. Primary data was retrieved from the respondents using self-administered semi-structured questionnaires accompanied by a research permit letter from the university through a drop and pick later method personally which gave the respondents enough time to complete and return the questionnaires. The targetted respondents included the accountants, internal auditors and finance managers of the banks. 3 questionnaires were issued out to each of the 34 banks that have been operational between 2007-2018, hence total questionnaires issued out was 102; 65 questionnaires were completed and collected from the respondents. The questionnaire containained closed-ended questions created by the researcher. The questionnaire was divided into 5 sections.

Section A assisted the researcher to collect demographic data about the respondnets (accountants, internal auditors and finance managers) which comprised of gender, job title, years of work experience, academic and professional experience and forms of executive compensation offered by respondents institution. Section B focused on the association between stock-based compensation and earnings management. Section C focused on the association between cash compensation and earnings management. Section D focused on the association between bonus payment and earnings management. Section E comprised of earnings management statements that were regressed against each independent variable represented by Sections B, C and D. The study used a 5 point Likert scale of agreement ("Stongly Disagree"; " Diagree"; "Undecided"; "Agree"; "Strongly Agree) for Sections B ,C, D and E. The study utilized a Likert scale of measurement because it helped to transform qualitative responses into quantitative values that can be statistically analyzed (Zikmund, Babin, Carr, & Griffin, 2010).

The study opted for the questionnaires as a suitable research instrument to collect primary data because it covered a large sample of participants when compared to interviews and focused group discussions (Peil & Rimmer, 1995). Furthermore, it was a cheap and faster technique of retrieving data when compared to other data collection tools (Kothari, 2004). Moreover, provided the best responses when the privacy of the respondents is assured (Peil & Rimmer, 1995).

3.6 Data Analysis Techniques

The analysis was done by using the Statistical Package for Social Sciences (SPSS) and EViews version 9.5 Software. The questionnaire data was cross sectional and thus SPSS was ideally suited for data interpretation. Secondary data was panel data and thus EViews version 9.5 software was the best to provide the underlying association by taking into account the time series effect in the data.

To establish the extent of earnings management practices in banks in Kenya, discretionary accrual was estimated as a proxy for earnings management. Models developed for calculating discretionary accruals in banking sector which mostly take into account loan loss provision (LLP) were used. Thereafter, descriptive statistics was employed which comprised of the mean, mean change, standard deviation to describe the data.

To determine the significance of the association between executive directors' remuneration and earnings management in banks in Kenya, secondary data analysis was used. Inferential analysis including panel data regression as well as stepwise regression was used to determine the relationship between the dependent and independent variables. The results were then presented in tables from which the interpretations were drawn.

To investigate the managerial perspective on the association between the executive directors' remuneration and earnings management in the Kenyan banking sector, the questionnaire was used. Descriptive statistics was employed on the primary dataset. It comprised of the mean, median and standard deviation which were used to describe the data.

As discussed in the literature review of the earnings management measurements, most of the previous literature were using discretionary accruals as a proxy of earnings management. The

various models identified in the subsections below were used to determine the discretionary accruals.

3.6.1 Discretionary Loan Loss Provision Model (DLLP)

LLP_{it}= β_1 $Size_{it}$ + β_2 ΔLoan $Charge\text{-}offs_{it}$ + β_3 $\Delta Loans_{it}$ + β_4 ΔNon-performing $Loans_{it}$ + β_5 ΔNon-performing $Loans_{it-1}$ + $\beta_6\Delta$Non-performing $Loans_{it+1}$+ ε_i

Where:

LLP_{it}= total loan loss provision for bank *i* at the year *t*,

$Size_{it}$=Total Assets

ΔLoan $Charge\text{-}offs_{it}$=represents the difference in total loan charge-offs between periods *t* and *t-1*

$\Delta Loans_{it}$=represents the difference in total loans between periods *t* and *t-1*

ΔNon-performing Loans=reflects the change in non-performing loans between periods *t* and *t-1*

ΔNon-performing $Loans_{it-1}$=reflects the change in non-performing loans between periods *t-1* and *t-2*

ΔNon-performing $Loans_{it+1}$= represents the change in non-performing loans between periods *t+1* and *t*

ε_i= The error term represents the unexplained component of the regression and hence is treated as the Discretionary Loan Loss Provisions (DLLP).

3.6.2 Beaver and Engel (1996) model

Total $PLLs_{it}$=α_0+α_1. NPL_{it-1} + α_2 .$CHGNPL_{it}$+ α_3 .$CHGLOANS_{it}$+ **ε**

where *Total* $PLLs_{it}$ is the provision for loan losses, NPL_{it-1} is the beginning period of nonperforming loans, $CHGNPL_{it}$ is the change in the value of the nonperforming loans, and $CHGLOANS_{it}$ is the change in the value of loans. All of the variables are deflated by the NPL_{it-1}

The fitted values are the NPLLs:

$$NLLPs_{it} = \hat{\alpha}0 + \hat{\alpha}1 \cdot NPL_{it-1} + \hat{\alpha}2 \cdot CHGNPL_{it} + \hat{\alpha}3 \cdot CHGLOANS_{it}$$

3.6.3 The Independent Variables

The executive directors' compensation comprising of cash, bonus and stock-based remunerations constituted the independent variables of this study. Cash, equity and bonus payments will be measured as the aggregate cash offered as it was the case of (Burns & Kedia, 2006), (Crutchley & Minnick, 2012), (Feng et al., 2011), (Zhang & Kryzanowski, 2013).

3.6.4 The Association between the Independent Variable and Dependent Variable

To establish the association between the executive director's remuneration (Independent variable) and earnings management (dependent variable) the multiple linear regression model was employed. The regression model was appropriate in assessing such analytical relationship between the variables since it describes the degree of cause and effect of the variables and their level of association (Kothari, 2004). (Ger, 2018) used the multiple linear regression model to assess the relationship between the executive compensation and earnings management in the context of non-financial firms in East Africa Region based on the secondary data retrieved. The regression equation below was developed to assess the relationship between the variables. The variables comprised of the dependent variable (earnings management), independent variables (executive compensation) and control variables (financial performance, bank size, firm growth, loan size, leverage and income diversification).

The linear regression model to analyze the association between executive directors' remuneration and earnings management was estimated as follows:

$$ALLPi,t = \alpha + \beta 1\ EXECCOMP_{i,t} + \beta 2\ FINANCIALPERF_{i,t} + \beta 3\ BANKSIZE_{it}, + \beta 4\ FIRMGROWTH_{i,t} + LOANSIZE_{i,t} + LEVERAGE_{i,t} + INCOMEDIVERSIFICATION_{i,t} \ldots\ldots\ldots\ldots (1)$$

Whereby; $ALLP_{i,t}$= Discretionary loan loss provision estimated from DLLP Model of firm i and time t

$EXECCOMP_{i,t}$ = Aggregate compensation offered (cash, stock and bonus) of firm i at time t

$FINANCIALPERF_{i,t}$ = Financial performance of firm (ROA) i at time t

$BANKSIZE_{i,t}$ = Firm size (asset size of the bank) i at time t

$FIRMGROWTH_{i,t}$= Firm growth (change in total liabilities) i at time t

$LOANSIZE_{i,t}$ = The total loans outstanding divided by total assets of firm i at time t

$LEVERAGE_{i,t}$ = Total debt divided by total assets of firm i at time t

$INCOMEDIVERSIFICATION_{i,t}$ = Non-interest income divided by total revenue of firm i at time t

Past research found correlations between these control variables and earnings management (for example, Bergstresser & Philippon, 2006; Cheng & Warfield, 2005) which made the findings robust by inclusion of the control variables.

3.7 Ethical Considerations

The study will maintain confidentiality and anonymity by making it clear to the respondents in the questionnaires that their names will not be used. All the responses that will be obtained from the respondents in the questionnaires and the secondary data will be aggregated for statistical analysis and interpretation without specifically profiling the firms by their names. The researcher will allow the participants to partake in this study freely out of their own will without being coerced or unfairly pressurized. Moreover, the researcher will respect the right of the participants not to take part in the study.

CHAPTER FOUR
PRESENTATION OF RESEARCH FINDINGS

4.1 Introduction

The study sought to investigate the association of executive compensation and earnings management among banks in Kenya. The objective was achieved by performing the following steps on the financial data; descriptive statistics, diagnostic tests and ordinary least square regression. The Ordinary Least Square (OLS) regression was supported by Eviews 9.5 software. OLS was performed after accounting for various assumptions of classical linear regression assumptions. Further, descriptive statistics was performed on the primary data from the questionnaires using SPSS.

4.2 Sample Representation

A total of 34 banks were included in the final analysis. As indicated in table 4.1, owing to data unavailability, banks under statutory management and receivership, acquisition of existing banks, new banks as well as banks which have not been operational from the year 2007 were omitted from the final sample.

Table 4.1: Summary of the number of Banks included in the study

Number of Banks over the years 2007 to 2018	46
Banks under statutory management with unavailable data	
Dubai Bank: Placed under statutory management on 14 August 2015 Charterhouse Bank Ltd: Placed under statutory management on 23 June 2007 Chase Bank: Placed under statutory management in April 2016 Imperial Bank: Placed under KDIC on 13 October 2015	(4)
Acquired Banks: Existing Banks:	
August 2017: Diamond Trust Bank Kenya Ltd acquired Habib Bank Kenya Ltd February 2017: Giro Bank was acquired by I&M Holdings Ltd	(2)
New Banks/not operational from 2007	
Mayfair Bank: commenced banking operations on 01 August, 2017 DIB Bank Kenya Ltd: Licenced in June 2017 Jamii Bora Bank: Founded in 2010 UBA Bank Kenya Ltd: Founded in 2009 First Community Bank: Started operations in 2008 Gulf African Bank: Started operations in 2008	(6)
Total sampled banks-295 observations	**34**

4.3 Descriptive Results on the Extent of Earnings Management among Banks in Kenya

Accrual-based earnings management was measured by estimating the level of discretionary accruals which was used as a proxy measure for earnings management. Bank-specific discretionary loan loss provision model identified in literature was used to estimate the discretionary accruals. The results indicate summary descriptive statistics of the discretionary accruals obtained from the model for the periods 2007-2018.

Table 4.2: Descriptive statistics on extent of earnings management among banks in Kenya

Year	Obs.	Min.	Max.	Mean	Mean Change	Median	Std. Dev	Skewness	Kurtosis
2007	34	-0.0239	0.0109	-0.0042		-0.0037	0.0069	-0.3334	4.4565
2008	34	-0.0202	0.0233	0.0011	0.0052	0.0000	0.0084	-0.0914	4.3712
2009	34	-0.0109	0.0450	0.0015	0.0004	-0.0006	0.0093	2.8941	14.1825
2010	34	-0.0080	0.0205	0.0008	-0.0006	-0.0005	0.0056	1.3472	5.9056
2011	34	-0.0083	0.0227	0.0004	-0.0005	-0.0004	0.0056	1.8464	7.9445
2012	34	-0.0063	0.0206	-0.0006	-0.0009	-0.0013	0.0049	2.4547	10.8394
2013	34	-0.0117	0.0066	-0.0012	-0.0006	-0.0015	0.0037	-0.1781	3.9706
2014	34	-0.0098	0.0273	-0.0010	0.0002	-0.0012	0.0063	2.6065	12.6491
2015	34	-0.0219	0.0319	0.0000	0.0010	-0.0003	0.0089	1.1835	7.2727
2016	34	-0.0114	0.0929	0.0049	0.0050	-0.0001	0.0175	3.8295	19.3998
2017	34	-0.0231	0.0248	-0.0005	-0.0054	-0.0011	0.0099	0.0655	3.4329
2018	34	-0.0766	0.0260	-0.0010	-0.0005	0.0006	0.0154	-3.3538	17.9105

The results indicate presence of discretionary accruals for the period 2007-2018 because where there is absence of earnings management, the discretionary accruals should be equal to zero (Salah, 2010). Nevertheless, the findings revealed the existence of discretionary accruals that both increased the income and reduced the income. From the findings, the maximum value observed between 2007 and 2018 was 0.0929 in 2016 while the minimum value of -0.0766 was observed in 2018 with the greatest mean change being -0.0054 between 2016 and 2017.

The average value of the discretionary accruals estimated by the discretionary loan loss provision model is illustrated below;

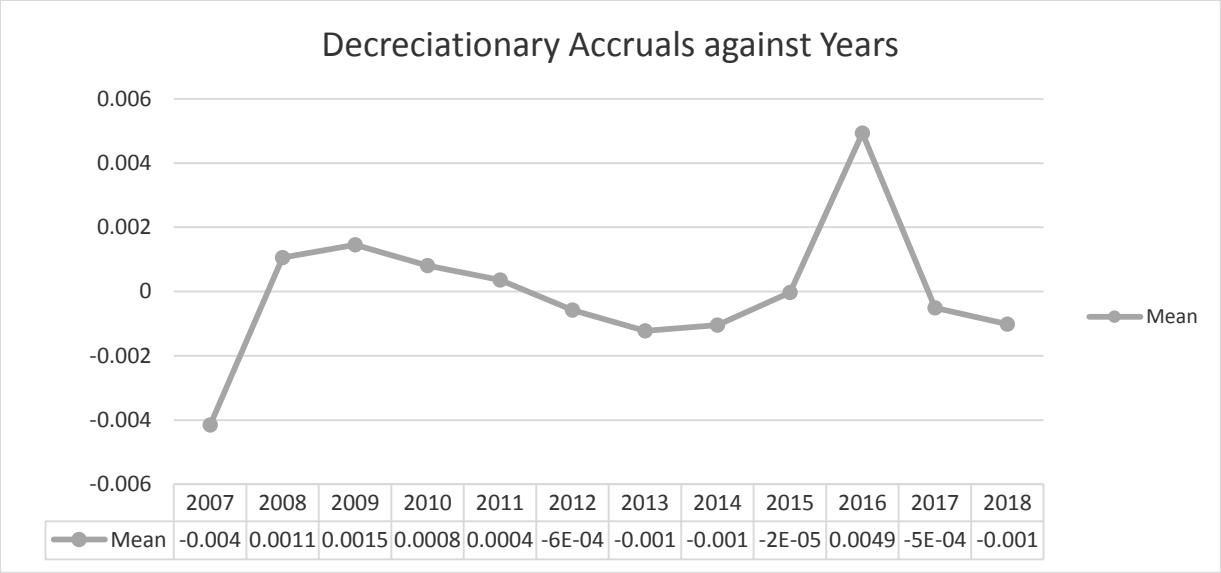

Figure 4.1 Pattern of Discretionary Accruals

The graph depicts that the average value of the discretionary accruals showed a sharp increase between the years 2007-2008 (0.0052), 2015-2016 (0.0050) and a sharp decrease between the years 2016-2017(-0.0054).

4.4 Diagnostic Tests for Ordinary Least Square (OLS) Assumptions

Before running the panel data multiple regression, the following diagnostics were performed on the residuals to make sure it supports all the OLS assumptions. The following tests were carried; multicollinearity, normality test, heteroscedasticity test, serial autocorrelation test and Hausman test.

4.4.1 Multicollinearity Test

Co-efficient of correlation values ranging from 0 to 1 calculate the degree to which two variables are related linearly with the higher magnitude suggesting a higher degree of association between two variables. (Adejimi, Oyediran, & Ogunsanmi, 2010) noted that a correlation coefficient of magnitude 0.3-0.5 indicated a medium linear independence between two variables while 0.5 to 1.0 indicated a strong linear dependence. It is worth noting that Spearman's correlation can be used when the data is not normally distributed.

Table 4.3: Covariance Analysis: Spearman rank-order

	EM	EC	ROA	Bank Size	Firm's Growth	Loan Size	Leverage	Income Diversification
EM	1.000							
EC	0.054 (0.374)	1.000						
ROA	-0.043* (0.041)	0.222* (0.000)	1.000					
Bank Size	-0.001* (0.006)	0.514* (0.000)	0.612* (0.000)	1.000				
Firm's Growth	0.064* (0.002)	-0.018* (0.000)	-0.120* (0.049)	-0.046* (0.007)	1.000			
Loan Size	-0.094* (0.007)	-0.076* (0.006)	0.120* (0.049)	-0.008* (0.007)	-0.031* (0.009)	1.000		
Leverage	0.021 (0.056)	0.127* (0.037)	0.010* (0.004)	0.076 (0.212)	-0.027* (0.003)	0.338* (0.000)	1.000	
Income Diversification	0.033 (0.057)	0.247* (0.000)	0.266* (0.000)	0.255* (0.000)	0.077* (0.002)	-0.183* (0.003)	-0.085* (0.007)	1.000

Notes: Parentheses are the p-values and * correspond to 5% significance levels

The matrix of correlation confirms that there is no multicollinearity among variables as none of the variables correlate above ±1.0. The correlation results indicated that executive compensation was positively associated to earnings management among commercial banks (r = 0.054, p = 0.374). Likewise, firm's growth was positively associated to earnings management (r = 0.064, p = 0.002), as well as leverage (r = 0.021, p = 0.056) and income diversification (r = 0.033, p = 0.057). Return on Assets was negatively associated to earnings management (r = -0.043, p = 0.041). Also, bank size had a negative association to earnings management (r = -0.001, p = 0.006) as well as size of loans (r = -0.094, p = 0.007).

4.4.2 Normality Test

Jarque-Bera test was performed which was a more definite test than the graphical approach. The null hypothesis under this test is that the residuals were normally distributed. If the p-value is less than 0.05, it was appropriate to reject the null of normality at the level of 5%.

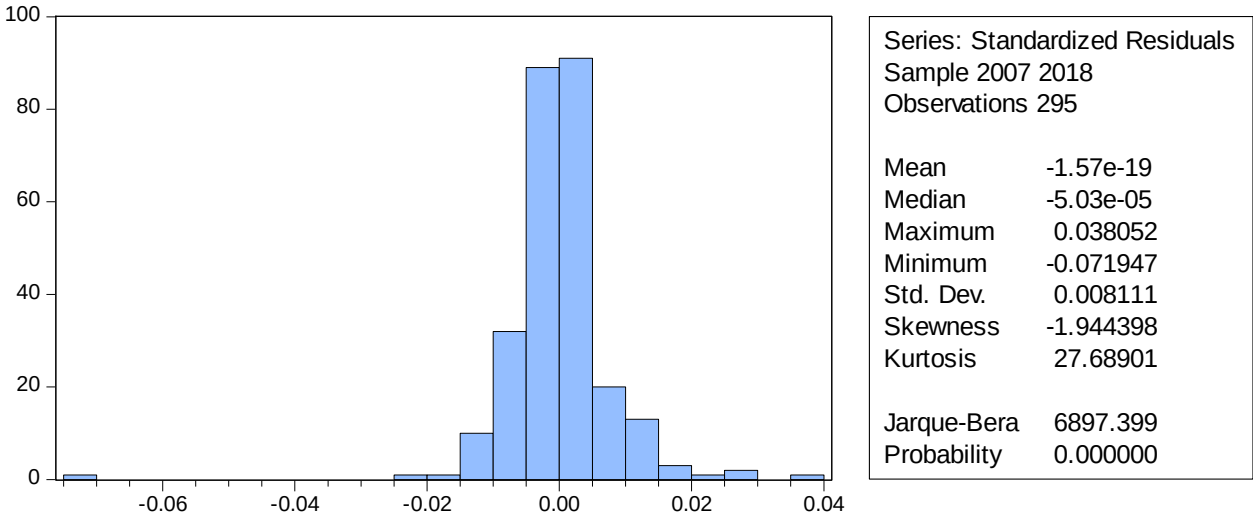

Figure 4.2: Normality test

In addition, the histogram would be bell-shaped and the Jarque-Bera statistic would not be significant if the residuals are normally distributed. This means that the *p*-value indicated at the bottom of the table should be higher than 0.05 to avoid rejecting the null of normality at the level of 5%. In view of the fact that the p-value for the residual was less than 5% (p=0.000000), the null hypothesis is rejected and hence the conclusion that the residuals are not normally distributed.

4.4.3 Heteroscedasticity Test

To test for heteroskedasticity, Breusch-Pagan-Godfrey test was used. The test's null hypothesis is that error terms have a constant variance, that is, will be Homoskedastic at significance levels of 5%.

Table 4.4: Heteroscedasticity Test

Heterockedasticity Test: Breusch-Pagan-Godfrey

F-statistic	7.501	Prob. F (4,268)	0.541
Obs*R-squared	5.471	Prob. Chi-Square (4)	0.693
Scaled explained SS	5.804	Prob. Chi-Square (4)	0.691

Test Equation:

Dependent Variable: RESID^2

Method: Least Squares

Date: 05/23/20 Time: 14:31

Sample: 2420

Included observations: 295

Variable	Co-efficient	Std. Error	t-Statistic	Prob.
EM	0.000	0.000	0.168	0.867
EC	0.000	0.000	0.557	0.578
ROA	-0.003	0.001	-3.439	0.001
Bank Size	0.000	0.000	-0.125	0.901
Firm's Growth	0.003	0.000	5.452	0.000
Loan Size	0.000	0.000	0.541	0.589
Leverage	-0.001	0.000	-1.965	0.051
Income Diversification	0.000	0.000	-0.945	0.346

R-squared	0.165	Mean dependent var	0.000
Adjusted R-squared	0.142	S.D. dependent var	0.000
S.E. of regression	0.000	Akaike info criterion	-13.225
Sum squared resid	0.000	Schwarz criterion	-13.118
Log likelihood	1793.383	Hannan-Quinn criter.	-13.182
F-statistic	7.381	Durbin-Watson stat	1.472
Prob(F-statistic)	0.000		

The test results indicated that the error terms are homoscedastic, given that the p-value is more than 5%. In this case, both the *F*- (7.501) and $\chi 2$ ('LM') (5.471) variants of the test statistics give the same result that there is no heteroscedasticity, because the *p*-values are considerably higher than 0.0.5, thus, the null hypothesis of constant variance was accepted.

4.4.4 Serial Autocorrelation

The Breusch-Godfrey serial correlation test was used to conform to the serial correlation. Serial correlation is a common problem faced in panel data analysis and must be taken into account in order to achieve the appropriate model specification. According to (Wooldridge, 2003), failure to recognize and account for serial correlation within a panel model's idiosyncratic error term can result in biased standard errors and inefficient estimates of parameters. The null hypothesis of this test was that at 5% level of significance, there was no first order autocorrelation in the data.

Table 4.5: Serial autocorrelation test

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	7.072	Prob. F (2,266)	0.410
Obs*R-squared	13.982	Prob. Chi-Square (2)	0.365

Test Equation:
Dependent Variable: RESID
Method: Least Squares
Date: 05/23/20 Time: 14:31
Sample: 2420
Included observations: 295
Presample and interior missing value lagged residuals set to zero.

Variable	Co-efficient	Std. Error	t-Statistic	Prob.
EM	-0.002	0.009	-0.244	0.808
EC	-0.001	0.001	-0.354	0.724
ROA	-0.001	0.023	-0.037	0.971
Bank Size	0.000	0.001	0.361	0.719
Firm's Growth	0.000	0.013	0.033	0.974
Loan Size	0.000	0.000	0.218	0.828
Leverage	0.002	0.008	0.194	0.847
Income Diversification	0.001	0.005	0.266	0.790
RESID (-1)	0.316	0.081	3.880	0.000
RESID (-2)	-0.078	0.093	-0.839	0.402

R-squared	0.049	Mean dependent var	0.000
Adjusted R-squared	0.016	S.D. dependent var	0.009
S.E. of regression	0.008	Akaike info criterion	-6.677
Sum squared resid	0.018	Schwarz criterion	-6.544
Log likelihood	911.447	Hannan-Quinn criter.	-6.624
F-statistic	1.494	Durbin-Watson stat	1.732
Prob(F-statistic)	0.000		

The p-value of both the *F*-(7.072) and $\chi 2$ ('LM') (13.982) versions was more than 0.05 implying the F test was statistically not significant. The null hypothesis of no autocorrelation is accepted and therefore residuals are not auto correlated. The data is considered from serial correlation if the statistic is within the range of 1.5 and 2.5 (Brooks, 2014). As seen from the above table, the test statistic is within the range of 1.5 to 2.5, indicating absence of serial correlation.

4.4.5 The Hausman Test for Model Effect Estimation

The Hausman test was done as was the case (Stephanie, 2017). It is often defined as a misspecification test for a model. The Hausman test in panel data analysis allows one to select between a fixed effects model and a model for random effects. The null hypothesis is that random effects is the ideal model, the alternate hypothesis is that the model is fixed effects. Essentially, the test seeks to see whether a relationship exists between the specific errors in the model and the regressors. Interpreting the outcome from a Hausman test is simple, whereby the null hypothesis is rejected if the p-value is small, less than 0.05.

Table 4.6: The Hausman test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	14.734	7	0.040

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var (Diff.)	Prob.
EC	-0.003	-0.001	0.000	0.268
ROA	-0.118	-0.085	0.000	0.105
Bank Size	0.007	0.002	0.000	0.067
Firm's Growth	-0.026	-0.024	0.000	0.646
Loan Size	0.000	0.000	0.000	0.839
Leverage	-0.020	-0.003	0.000	0.108
Income Diversification	0.018	0.009	0.000	0.192

The Hausman test was used to assess the model that best fit this analysis. The Chi-square test statistic was 14.734 with a significant probability of 0.040 which meant that the null hypothesis was rejected in favor of the fixed effects model. Thus, we accept the fixed effects model as suitable for this analysis.

4.5 The Association between Executive Compensation and Accrual-Based Earnings Management

The regression model helps to explain the direction and magnitude and direction of the relation between the study variables by using coefficients such as the beta coefficient and the significance level. The study adopted a fixed effect model based on the diagnostic tests performed, and the result presented were to demonstrate the fitness of the model used by the regression model in describing the study phenomena.

Table 4.7: Regression to test the association between executive compensation and accrual-based earnings management

Fixed effect Regression
Dependent Variable: EM
Method: Panel Least Squares
Sample (adjusted): 2007- 2018
Cross-sections included: 31
Total panel (unbalanced) observations: 295

Variable	Co-efficient	Std. Error	t-Statistic	Prob.
EM	-0.154	0.052	-2.968	0.003
EC	-0.001	0.003	-0.211	0.333
ROA	-0.166	0.036	-4.585	0.000
Bank Size	0.021	0.006	3.259	0.001
Firm's Growth	-0.026	0.013	-2.000	0.047
Loan Size	-0.000	0.000	-0.676	0.500
Leverage	-0.024	0.014	-1.683	0.044
Income Diversification	0.021	0.011	1.969	0.050
Effects Specification				
Cross-section fixed (dummy variables)				
Period fixed (dummy variables)				
R-squared	0.311	Mean dependent var		0.000
Adjusted R-squared	0.165	S.D. dependent var		0.009

S.E. of regression	0.008	Akaike info criterion	-6.668
Sum squared resid	0.014	Schwarz criterion	-6.029
Log likelihood	948.247	Hannan-Quinn criter.	-6.412
F-statistic	2.133	Durbin-Watson stat	1.452
Prob(F-statistic)	0.000		

The regression results presented indicates association between earnings management and executive compensation. The results indicate that the association is negative but not statistically significant between executive compensation and earnings management among Kenyan commercial banks as is shown by the p-value of the co-efficient (0.333) which is more than the level of significance, 0.05. The insignificant effect may be due to the fact that financial incentives such as bonuses does not encourage executive directors to pursue earnings management as their motivating impact is short lived. The R-squared for the model is 31.1% and statistically significant at 0.000 implying that only 31% change in earnings management is explained by executive compensation. This means that other variables not mentioned in the model account for 69% of the changes in earnings management. The regression model is statistically significant demonstrated by the F-statistic p-value, which is 0.000, less than the level of significance of 0.05.

Further, the association between earnings management and the control variables indicate that; first, return on assets was negatively correlated at -0.166 with earnings management and statistically significant at 5% level with a p-value of 0.000 that is less than 0.05. This indicates that poorly performing banks may exploit their financial reports more, in particular through their LLP accounts as opposed to highly performing firms. Second, bank size was positively correlated with earnings management at 0.021 and statistically significant at 5% percent level with p-value of 0.001 that is less than 0.05 which implies that big corporations are more likely to be involved in accrual-based earnings management. Third, firm growth was negatively correlated with earnings management at -0.026 and statistically significant at 5% percent level with p-value of 0.047 that is less than 0.05 implying that low growth banks have a higher degree of earnings management. Fourth, the results indicated insignificant negative association at -0.000 between size of loans and earnings management with a p-value of 0.500 that is more than 0.005. Fifth, the results indicated significant negative effect at -0.024 between leverage and earnings management with p-value of 0.044 that is less than 0.05 indicating that high leveraged banks have less probability of managing

earnings due to the creditors tracking performance. Lastly, the results indicated significant positive association at 0.021 between income diversification and earnings management with a p-value of 0.05 which is equal to 0.05 implying that commercial banks are prompted to explore alternative channels of revenue in order to maintain their earnings, hence a greater likelihood of earnings management. Thus, in conclusion, when considering the control variables, the outcome of the regression implies that larger, weaker, less leveraged banks with revenue diversification engage more in earnings management while the growth variable indicates that low growth banks are pursuing more earnings management as indicated by the negative and significant coefficients.

In addition to the panel data regression conducted, I applied a stepwise regression between earnings management and executive compensation to validate the results of the regression. The results are as tabulated below;

Table 4.8: Stepwise Regression Results

Dependent Variable: EM
Method: Stepwise Regression
Date: 07/15/20 Time: 22:13

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.000358	0.005577	-0.064105	0.9489
EC	0.000108	0.001208	0.089793	0.9285

R-squared	0.000228	Mean dependent var	0.000141
Adjusted R-squared	-0.003505	S.D. dependent var	0.008610
S.E. of regression	0.008625	Akaike info criterion	-6.661348
Sum squared resid	0.021052	Schwarz criterion	-6.635716
Log likelihood	951.2421	Hannan-Quinn criter.	-6.651073
F-statistic	0.008063	Durbin-Watson stat	1.345508
Prob(F-statistic)	0.000000		

The results of stepwise regression indicate that there is no significant relationship between earnings management measured by discretionary accruals with executive compensation at 5% significance level with a p-value of 0.9285 which is greater than 0.05. The finding further corroborates with the results of the panel data fixed effect regression model.

4.6 Managerial Perception on the Extent of Earnings Management and its Association to Executive Directors' Compensation (Primary Data Analysis)

The study applied a triangulation approach to the findings obtained from the banks' financial statements with the results obtained from the banks sampled through the questionnaires. The survey data was used to respond to the specific objective three which sought to investigate the managerial perspective on the association between the executive director's compensation and earnings management in the Kenyan banking sector. The questionnaire was divided into two parts; Section A which focused of the demographics of those surveyed and Section B, C, D and E which focused on specific questions relating to the forms of executive compensation and earnings management.

4.6.1 Response Rate

Three questionnaires (Accountants, Internal Auditors and the Finance Managers) were sent to the 34 sampled banks that have been operational from 2007. Out of the 102 questionnaires issued, 65 were received making the response rate to 64%.

4.6.2 Demographic Profile of the Respondents

The study sought demographic information to determine the respondent's ability to provide accurate information. The details sought included the gender, job title, number of years employed, highest level of education, professional certification and forms of executive compensation offered by respondents' institution. The findings are presented in the table below;

Table 4.9: Demographic Profile of the Respondents

Item		Frequency	Percent
Gender of the Respondents	Male	41	63%
	Female	24	37%
Job Title of the Respondents	Accountants	21	32%
	Auditors	15	23%
	Finance Managers	7	11%
	Relationship Managers	4	6%
	Branch Managers	3	5%
	Customer Service	3	5%
	Sales Advisors	2	3%
	Managers	1	2%
	Not specified	9	14%
Respondents Working Experience	Less than 1 year	9	14%
	1-5 years	29	45%
	5-10 years	14	22%
	More than 10 years	13	20%
Respondents Highest Level of Education	Bachelor's Degree	40	62%
	Higher Diploma	4	6%
	Master's Degree	16	25%
	Doctorate Degree	5	8%
Respondents Professional Certification	CPA	42	65%
	ACCA	13	20%
	CISA	3	5%
	CFE	2	3%
	CFA	0	0%
	Other	1	2%
	Not Specified	4	6%
Forms of Executive Compensation offered by Respondents Institution	Cash	58	89%
	Bonus	4	6%
	Equity Options	0	0%
	Long-term incentive plan	0	0%
	Other	3	5%

The results obtained indicated that many respondents were male represented by 63% while female was 37%. Second, majority of the respondents were accountants at 32%, auditors 23%, finance managers 11%, relationship managers 6%, branch managers 5%, customer service 5%, sales advisors 3%, managers 2% and those who didn't specify were 14%. This implied that majority of the respondents (accountants, auditors and finance managers) (66%) were from the targeted population sample therefore well informed with the banks' operations hence gave reliable

information. Third, many respondents have worked in the bank for 1-5 years at 45%, 5-10 years at 22%, more than 10 years 20% and less than a year 14%. Fourth, the highest level of education of the respondents is bachelor's degree represented by 62%, followed by 25% with master's degree, 8% with a doctorate degree and 6% with a higher diploma. Fifth, majority of the respondents had CPA qualification represented by 65%, followed by 20% with ACCA, CISA with 5%, CFE with 3%, Others with 2% and those who didn't specify were 6%. Lastly, it was also observed that majority of the banks use cash as the main form of executive compensation represented by 89%, followed by bonus with 6% and lastly 5% others.

4.6.3 Association between Executive Compensation and Earnings Management

This objective was measured on a set of statements in which the respondents were requested to rate each one of them regarding director's executive remuneration (cash, bonus, equity, long term incentive and others) and earnings management. The Likert scale was used where 1 represented strongly disagreed, 2 disagreed, 3 undecided, 4 agreed and 5 strongly agreed. Each form of executive remuneration was addressed separately, and the descriptive statistics was performed on the responses and results illustrated using tables.

4.6.3.1 Stock-Based Compensation and Earnings Management

From the findings, majority of the respondents seem to agree that stock-based compensation motivates and provides incentives to directors to engage in earnings management with highest mean of 3.35 in Q1 and standard deviation of 1.28, closely followed by Q4 with mean of 3.23 and standard deviation 1.27, further, Q2 with of mean of 3.15 and standard deviation of mean of 1.44 and lastly Q3 with mean of 2.85 and 1.51.

Table 4.10: Descriptive Statistics of Stock-Based Compensation and Earnings Management

Statements	N	Min.	Max.	Mean	Std. Dev
Banks offering Stock-Based Compensation contracts to the executives tagged on financial performance experience cases of Earnings Management.	65	1	5	3.35	1.280
Executives' remuneration tagged on stock prices of a bank motivates the directors to manipulate earnings for personal enrichment.	65	1	5	3.15	1.439
Executives' remuneration tied on stock prices of encourages the directors to manipulate earnings to sort out personal problems and debts.	65	0	5	2.85	1.513
Executives' Equity-Based Compensation tied on financial performance of a bank provides incentives to the directors to manipulate earnings and conceal poor performance with an aim to continue earning excess remuneration.	65	1	5	3.23	1.272

4.6.3.2 Cash Compensation and Earnings Management

From the findings, most of the respondents seem to disagree that cash compensation influences and motivates directors to engage in earnings management with highest mean of 3.06 in Q4 and standard deviation of 1.40, closely followed by Q1 with mean of 3.00 and standard deviation 1.46, further, Q2 with of mean of 2.25 and standard deviation of mean of 1.05 and lastly Q3 with mean of 2.18 and 1.20.

Table 4.11: Descriptive Statistics of Cash Compensation and Earnings Management

Statements	N	Min.	Max.	Mean	Std. Dev
The executives' basic salary does not provide the directors any motivation to manipulate reported earnings.	65	1	5	3.00	1.458
Executives' Cash Compensation provides enough justification for directors to restate financial reports.	65	0	5	2.25	1.046
Cases of bank's executive basic salary influencing directors to manipulate financial statements is common.	65	1	5	2.18	1.198
Executive cash compensation does not have any kind of association with earnings management in the bank.	65	0	5	3.06	1.402

4.6.3.3 Bonus Payment and Earnings Management

From the findings, majority of the respondents seem to agree that bonus compensation is linked with financial statements manipulation by directors with highest mean of 3.08 in Q4 and standard deviation of 1.30, closely followed by Q3 with mean of 2.78 and standard deviation 1.40, further, Q2 with of mean of 2.60 and standard deviation of mean of 1.21 and lastly Q1 with mean of 2.14 and 1.03.

Table 4.12: Descriptive Statistics of Bonus Payment and Earnings Management

Statements	N	Min.	Max.	Mean	Std. Dev
Bonus payments tagged on financial performance of a firm motivates directors to choose accounting methods that increases the reported income of the firm at the end of the financial period.	65	1	5	2.14	1.029
Executive bonus payment contracts do not provide the directors any kind of motivation to manipulate financial statements.	65	1	5	2.60	1.209
Banks offering excessive bonuses creates a corporate culture of personal gains at the expense of shareholders' wealth.	65	1	5	2.78	1.397
Many firms in Kenya linked with manipulation of financial statements offers high executive bonuses.	65	1	5	3.08	1.303

4.6.4 Extent of Earnings Management

The extent of earnings management was assessed by inquiring from the respondents about techniques used in earnings management practice. From the results, most of the respondents seem to agree that there is presence of earnings management among banks in Kenya through practices such as improper revenue recognition, understatement of expenses, overstatement of cashflows and overstatement of profits with the highest mean recorded in Q1 with 2.38 and standard deviation of 1.11, closely followed by Q2 with mean of 2.28 and standard 1.23, Q4 with mean of 2.09 and standard deviation of 1.04 and lastly, Q3 with mean of 2.0 and standard deviation of 1.0**.**

Table 4.13: Descriptive Statistics of indicators of Earnings Management

Statements	N	Min.	Max.	Mean	Std. Dev
Directors conduct improper revenue recognition using accounting standards to maximize their personal wealth tied on financial performance.	65	1	5	2.38	1.114
Directors understates banks' real expenses to increase reported earnings so that their executive compensation tied on financial performance can be assured.	65	1	5	2.28	1.231
Directors use available accounting methods to overstate profit so that their excess remuneration based on equity options or bonus payments can be guaranteed.	65	0	5	2.00	1.000
Directors overstates cash flows to increase the firm's reported earnings to receive more remuneration.	65	1	5	2.09	1.042

4.7 Comparison of Findings from Secondary Data and Primary Data

The results from both the primary and secondary sources tend to be compatible. Respondents (44%) seem to agree that there is presence of earnings management among banks in Kenya through improper revenue recognition, understating expenses, overstating profit and overstating cashflows. Descriptive statistics from secondary data also revealed presence of discretionary accruals, which is a proxy for earnings management.

However, the results were inconsistent with regards to the association between executive compensation and earnings management. Secondary data revealed negative association between earnings management and executive compensation whilst respondents believed that stock compensation (63%) and bonus payment (53%) had a positive impact on earnings management while cash compensation (61%) had none.

4.8 Summary of Data Analysis Findings

This chapter explained how data was analyzed in order to meet the research objectives. The first objective was to establish the extent of earnings management practices in banks in Kenya. The means and standard deviations over the years 2007-2018 were computed for 34 commercial banks, and the results showed income increasing and income decreasing discretionary accruals which indicated presence of earnings management among the banks over the years. The second objective was to determine the significance of the association between executive directors' remuneration and earnings management in banks in Kenya. The results indicated that the association is negative and insignificant between executive compensation and earnings management which implied that financial incentives such as bonuses does not encourage executive directors to pursue earnings manipulation as their motivating impact is short-lived. The third objective was to investigate the managerial perspective on the association between the executive directors' remuneration and earnings management in the Kenyan banking sector. The executive compensation variable was disaggregated into cash, bonus and stock-options. Respondents believed that stock-options and bonus payment had a positive impact on earnings management while cash compensation had none. They also believed that there is presence of earnings management practices among banks in Kenya through improper revenue recognition, understating expenses, overstating profit and overstating cashflows.

CHAPTER FIVE
DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings as regards the objectives of the study. It also includes the study's conclusion, the research constraints noted and finally recommendations issued for further study.

5.2 Review of the Results

The study aimed at determining the association between executive director's remuneration and earnings management among banks in Kenya. The objectives of the study therefore were to determine the extent of earnings management practices in banks in Kenya; to establish if there is an association between executive directors' remuneration and earnings management in banks in Kenya and to obtain the managerial perspective on the association between the executive directors' remuneration and earnings management in the Kenyan banking sector. The sample representation consisted of 34 Kenyan commercial banks over the 12-year period, 2007-2018. The association was evaluated using fixed effects model. The survey data obtained from questionnaires was used to obtain managerial perspective.

5.2.1 Determining the Extent of Earnings Management Among Banks in Kenya

The aim of this analysis was to estimate the extent of earnings management using accrual-based earnings management strategy. Discretionary accruals were used as a metric for measuring accrual-based earnings management in consistent with previous earnings management studies. Bank specific models developed, Discretionary Loan Loss Provision Model (DLLP) and (Beaver & Engel, 1996) model was used in estimating discretionary accruals using Loan Loss Provisions (LLPs).

We find some evidence to indicate that Kenyan banks use LLP for earnings management among the 34 Kenyan commercial banks as it was observed to consist of both income increasing and income decreasing discretionary accruals, but none were equal to zero. In a case where there is no earnings management, the values will equal zero (Salah, 2010). Negative values are income

decreasing whereas positive values are income increasing. Throughout the years, the trend in discretionary accruals are both income-increasing and income-decreasing accruals. This finding is consistent with prior studies (Collins, Shackelford, & Wahlen, 1995; Bhat, 1996). (Collins, Shackelford, & Wahlen, 1995) noted that banks were using LLPs as a tool for earnings management. They pursued a bank-by-bank approach and found that about two-thirds of the banks used LLPs for income smoothing purposes in their survey of 160 U.S. banks. (Bhat, 1996) also concludes that there is a strong relationship between LLPs and earnings for his sample of U.S. banks. He finds that banks that are characterized by low growth, low book-to-asset ratios, high loans-to-deposit ratios, high debt-to-asset ratios, low return on assets, high loan loss provisions-to-gross loans ratios and low assets are likely to smooth earnings. When analyzing the trends of discretionary accruals, between the years 2007-2008 (0.0052), 2015-2016 (0.0050) and 2016-2017 (-0.0054), a great shift is observed. The drastic shift in discretionary accruals could be related to disclosure of directors' remuneration as required by the Companies Act, 2015 regulations.

5.2.2 The Association Between Executive Compensation and Earnings Management

To determine the association between executive compensation and earnings management, panel data and stepwise regression was performed. The results from both regressions indicated that the estimated co-efficient on the variables are negative and not statistically significant. This result indicates that discretionary accruals does not lead to an increase in the pay of executives in the subsequent periods. One possible explanation for this result from the regression may be the fact that it's not the executives who are the key practitioners of earnings management, but rather the manipulation of earnings could be initiated at lower levels in the company with or without the executives' knowledge. Where the executives lack knowledge about the manipulation and report numbers he believes to give a correct image of the company he would not actively seek the potential increase in compensation and the association to discretionary accruals would be insignificant. Intuitively, executives are less likely to engage in accruals manipulation to obtain financial benefits if this method is costly (Zang, 2012), and easy to detect. This weakens the relationship between executive compensation and accruals management. This finding backs the theoretical hypothesis that executive interests are aligned with shareholders' interests. In fact, and according to the agency theory, shareholders are enforcing optimal arrangements with executives whose compensation ensures a convergence of interests and reduces agency problems. Thus, the

executive would be less opportunistic with a higher pay, decreasing his ability to manipulate the performance of the business and altering the contract binding the shareholders. This finding was consistent with (Zhou, Wang, Zhang, & An, 2018), (Gabrielsen, Gramlich, & Plenborg, 2002) and (Spinos, 2013) who found that the association between managerial ownership and earnings management at 5% significance level was not significant implying that there is no systematic relationship between these two variables. Also, inconsistent with (Hassen, 2014) who found the relationship to be negative and significant as well as (Karimi, Ahmadian, & Bastami, 2014), and (Lakhal et al., 2014), (Li, 2017), (Njogu, 2016) who found a significant positive relationship.

Further, the association between earnings management and the control variables indicate that first, there is negative significant association between return on assets and earnings management among commercial banks in Kenya. This indicated that banks with inferior operating performance (measured via ROA) experienced levels of earnings management that occurred via loan loss provision and that poorly performing banks may exploit their financial reports more, in particular through their LLP as opposed to highly performing firms. Second, the results indicated that there was a positive significant association between bank size and earnings management among commercial banks in Kenya which implied that larger banks are more likely to manage earnings when undesirable earnings are experienced. Third, the results indicated that there is negative significant association between firm's growth and earnings management among commercial banks in Kenya which implied that low growth banks had a higher probability of manipulating earnings. Fourth, the results indicated negative insignificant relationship between size of loans and earnings management. Fifth, the results indicated negative significant effect between leverage and earnings management which can be concluded that when the financial leverage of the bank increases (decreases), and the level of borrowing and debt in banks increases (decreases), the possibility of managing earnings decreases (increases). This is because, banks creditors track performance and activities and with an increased level of financial leverage, the probability of earnings management is reduced. Lastly, the results indicated positive significant association between income diversification and earnings management. The results indicate that diversification has prompted commercial banks to explore alternative channels of revenue in order to maintain their earnings, hence a greater probability of earnings management.

5.2.3 Managerial Perception on The Extent of Earnings Management and its Association to Executive Directors' Compensation

Results from the questionnaires indicated that most of the respondents believed that stock-based compensation contracts to the executives tagged on financial performance experience cases of earnings management. They also agreed that equity-based compensation tied on financial performance of a bank provided incentives to the directors to exploit earnings and mask poor results with an aim to continue earning excess remuneration. They agreed that executives' remuneration tagged on stock prices of a bank motivates the directors to manipulate earnings for personal enrichment. They further agreed that executives' remuneration tied on stock prices of encourages the directors to manipulate earnings to sort out personal problems and debts. This result was in line with (Armstrong, Larcker, Ormazabal, & Taylor, 2013), (Bergstresser & Philippon, 2006), (Boumosleh, 2009), (Burns & Kedia, 2006), (Jiang et al., 2010), (Feng et al., 2011), (Kim et al., 2013), (Hass et al., 2016), (Ling, 2016) which had shown that executive director's remuneration regarding stock-based compensation has a positive significant relationship with earnings management.

The respondents also believed cash compensation not only did it not have any kind of association with earnings management but also that the executives' basic salary did not provide the directors any motivation to manipulate reported earnings. The findings were consistent with (Persons, 2012) who established that there was no significant relationship between directors' cash remuneration and the probability of earnings manipulation. In addition, majority of the respondents seemed to agree that many firms in Kenya linked with manipulation of financial statements offered high executive bonuses. They also believed that Banks offering excessive bonuses creates a corporate culture of personal gains at the expense of shareholders' wealth, which was inconsistent with studies conducted by (Burns & Kedia, 2006; Erickson et al., 2006; Harris & Bromiley, 2007) which revealed no significant relationship between bonus payments and earnings management.

The respondents consented that Directors conducted improper revenue recognition using accounting standards to maximize their personal wealth tied on financial performance. They were also in strong agreement that Directors understated banks' real expenses to increase reported earnings so that their executive compensation tied on financial performance can be assured.

Respondents were in agreement that Directors overstated cash flows to increase the firm's reported earnings to receive more remuneration. Further, respondents agreed that Directors used available accounting methods to overstate profit so that their excess remuneration based on equity options or bonus payments can be guaranteed. Overall, respondents were in consensus with the various statements on earning management practices which were; improper revenue recognition, understating banks' real expenses to increase reported earnings, overstating cash flows to increase the firm's reported earnings and use of available accounting methods to overstate profit. The findings were consistent with (Waiguru, 2013).

5.3 Conclusion

The incentive compensation may have an effect not just on bank's risk-taking practices but also on their earnings management. This is because earnings management impacts financial results when compensation is determined through performance-related reflection. The aim of this analysis was to estimate the extent of earnings management using accrual-based earnings management strategy. The results of this study present income increasing and income decreasing discretionary accruals over the period 2007-2018 for the 34 commercial banks in Kenya. The greatest shift mean value of change in earning management measured by discretionary accruals (Discretionary Loan Loss Provision Model) model was -0.0054 observed between the years 2016-2017 which implied that there was presence of earnings management since where there was absence of earnings management, the discretionary accruals should be equal to zero (Salah, 2010).

The research also aimed to establish if there was an association between executive directors' remuneration and earnings management in banks in Kenya. Based on the regression results, there was negative and insignificant association between executive compensation and earnings management among Kenyan commercial banks which was inconsistent with the positive accounting theory which hypothesizes that, the more the pay is based on performance, the higher the possibility of earnings management. However, the finding was consistent with the agency theory whereby shareholders enforce optimal contracts with executives whose remuneration ensures the alignment of interests and minimizes agency problems. Further, the results indicated significant association for the control variables; negative association with return on assets, which indicated that poorly performing banks may exploit their financial reports more, in particular

through their LLP accounts as opposed to highly performing firms; positive association with bank size which indicated that large firms are more likely to engage in accrual-based earnings management, negative association with firm's growth implying that low growth banks have a higher prospect of earnings management, negative association with leverage which implied that high leverage reduces possibility of earnings management through close monitoring of performance by creditors, positive association with income diversification which indicated that banks are exploring other channels of revenue to manage earnings and an insignificant negative association with size of loans.

The study also aimed at obtaining managerial perspectives on the extent of earnings management and its association to executive compensation among banks in Kenya. Majority of the respondents seemed to agree that there was presence of earnings management among banks in Kenya who also seemed to agree that stock - based compensation and bonus payments to executives is related to earnings management. Most respondents did not seem to agree that cash compensation is related to earnings management.

5.4 Recommendations

5.4.1 Policy Makers and Industry Regulators

Given that banks engage in earnings management practices, the study can enable policy makers and industry regulators such as the Central Bank of Kenya to be able to monitor trends and patterns of the practice and therefore issue regulations and guidelines to the banks.

In addition, due to the versatility of accounting methods, banks were found to be able to participate in unethical earnings management activities, this study recommends that ICPAK, the accounting oversight body, establish adequate steps to allow it to resolve the gaps resulting from the flexibilities in the accounting methods in the interests of improved financial efficiency of banks.

5.4.2 Researchers and Scholars

The current study sought to establish the association between executive compensation and earnings management among Kenyan commercial banks. The research was performed successfully but a number of gaps were found that could create a gap for future studies. Firstly, an improved bank

specific model of estimating discretionary accruals could be used for a similar analysis. The analysis model should incorporate control variables, particularly bank specific factors into the analysis to improve the robustness of the estimation model. In addition, the same study could also be performed for the deposit taking SACCOs to observe if the results hold.

5.5 Contribution to Knowledge

This result has contributed to empirical research in that very few accounting studies have confirmed the impact of incentive compensation on financial firms. This study has contributed to the literature body by exploring the association between executive compensation and earnings management by focusing on a bank specific accrual (loan loss provision); a proxy for earnings management, to supplement earlier work. The findings of this paper present an important implication for regulators in Kenya to reduce earnings management practices that occur via manipulation of the loan loss provision in the banking industry because there is a tendency of banks to earnings management practices as a significant change in the pattern of discretionary accruals was observed. From the results, the insignificant relationship between executive compensation and earnings management implies that there are other incentives other than compensation which impact on earnings management. Further, in an effort to better grasp the nature of earnings management, the analysis sought the views of industry participants.

5.6 Research Limitations

During the analysis, the researcher faced various limitations which had to be handled to produce reliable results. On the secondary data collection, researcher relied on data obtained from commercial banks' financial statements which management and conservatism may control certain figures. In addition, various banks whose operations were suspended during the period under the study (Charterhouse Bank, Dubai Bank, Imperial Bank and Chase Bank), acquired over the period of study (Habib Bank and Giro Bank) and banks which have not been operational from 2007 (Gulf African Bank, First Community Bank, UBA Bank, Jamii Bora, DIB Bank and Mayfair Bank) affected the ease with which secondary data needed for analysis was collected. Although the study used the census approach, some banks had to be omitted due to incomplete data. Since earnings management is a sensitive issue, some of the respondents were reluctant or unwilling to partake in the study citing policies that prevented them from providing information before obtaining

approvals. Furthermore, the other model proposed to be used in determining discretionary accruals, (Beaver & Engel, 1996) failed all the diagnostic tests hence the study only relied on Discretionary Loan Loss Provision Model (DLLP).

5.7 Areas for Further Research

It is recommended that other bank specific analytical tools and models be used which are more suitable so as to achieve more precise results. In addition, the R-squared for the model was 31.1% inferring that only 31.1% variation in earnings management is explained by executive compensation which suggests that there are other factors explaining the variance. Further research is required to identify factors other than the variables used in this study that affect earnings management.

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APPENDICES

Appendix I: Research Permit Letter

Strathmore UNIVERSITY

06 May 2019

TO WHOM IT MAY CONCERN

Facilitation of Research for Mohamed Yasmin Samir Student No. 101874

Ms Mohamed Yasmin Samir is a postgraduate student in our Master of Commerce (MCom) programme. In partial fulfilment of the MCom degree, students are required to carry out a research project and write a thesis on a contemporary subject within their field of specialisation. Among other activities, the project involves data collection and analysis.

Yasmin is requesting to gather information to be used in her research. The information she will obtain from your organization will be used for this academic purpose only and will be kept confidential. The results of the survey will be in summary form and will not disclose any individual, company name or company information in any way.

Our MCom seeks to establish links with industry, and one of these ways is by directing our research to areas that would be of direct use to industry. We would be glad to share the findings with you after the research, and we trust that you will find them of great interest and of practical value to your organization.

The research study is entitled **"Relationship between Executive Directors Remuneration and Earnings Management among Financial companies in Kenya."**

We appreciate your support and shall be willing to provide any further information if required.

Yours faithfully,

Quindos Karanja
Strathmore University Business School
Email: qkaranja@strathmore.edu

Ole Sangale Rd, Madaraka Estate. PO Box 59857-00200, Nairobi, Kenya. Tel +254 (0)703 034000
Email admissions@strathmore.edu www.strathmore.edu

Appendix II: Ethical Review Approval Letter

Strathmore UNIVERSITY

4th February 2020

Ms Mohamed, Yasmin
yasmin.mohamed@strathmore.edu

Dear Ms Mohamed,

RE: Association Between Executive Directors' Remuneration and Earnings Management Among Banks in Kenya

This is to inform you that SU-IERC has reviewed and **approved** your above research proposal. Your application approval number is **SU-IERC0549/19.** The approval period is **4th February, 2020 to 3rd February, 2021.**

This approval is subject to compliance with the following requirements:

i. Only approved documents including (informed consents, study instruments, MTA) will be used
ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC.
iii. Death and life threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IERC within 72 hours of notification
iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IERC within 72 hours
v. Clearance for export of biological specimens must be obtained from relevant institutions.
vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
vii. Submission of an executive summary report within 90 days upon completion of the study to SU-IERC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology and Innovation (NACOSTI) https://oris.nacosti.go.ke and also obtain other clearances needed.

Yours sincerely,

for: Dr Virginia Gichuru,
Secretary; SU-IERC

STRATHMORE UNIVERSITY INSTITUTIONAL ETHICS REVIEW COMMITTEE (SU-IERC)
04 FEB 2020
TEL: +254 (0)703 034 000
P. O. Box 59857 - 00200
NAIROBI - KENYA

Cc: Prof Fred Were,
Chairperson; SU-IERC

Ole Sangale Rd, Madaraka Estate. PO Box 59857-00200, Nairobi, Kenya. Tel +254 (0)703 034000
Email info@strathmore.edu www.strathmore.edu

Appendix III: NACOSTI Approval

REPUBLIC OF KENYA

NATIONAL COMMISSION FOR SCIENCE,TECHNOLOGY & INNOVATION

Ref No: **186565**

Date of Issue: **16/March/2020**

RESEARCH LICENSE

This is to Certify that Ms.. Yasmin Samir Mohamed of Strathmore University, has been licensed to conduct research in Nairobi on the topic: ASSOCIATION BETWEEN EXECUTIVE DIRECTORS' REMUNERATION AND EARNINGS MANAGEMENT AMONG BANKS IN KENYA for the period ending : 16/March/2021.

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Appendix IV: Questionnaire

This survey intends to collect data on the association between Executive Directors' Remuneration and Earnings Management among banks in Kenya. With great humility, you are kindly asked to answer the questions in this questionnaire. Responses will be treated with utmost confidentially. Your voluntary participation in this survey will be greatly cherished.

SECTION A: DEMOGRAPHIC PROFILE

1. Gender: Male ☐ Female ☐

2. Job Title: Accountant ☐ Auditor ☐ Finance Manager ☐

Other (specify) ……

3. Years of banking experience: Less than a year ☐ 1-5 years ☐ 5- 10 years ☐

More than 10 years ☐

4. Highest level of education: Bachelor's Degree ☐ Higher Diploma ☐ Master's degree ☐

Doctorate Degree ☐

5. Current certification: CPA ☐ ACCA ☐ CISA ☐ CFE ☐ CFA ☐

Other.....

6. What are the forms of executive remunerations offered by the institution?

i. Cash ☐

ii. Bonus ☐

iii. Equity options ☐

iv. Long-Term incentive plan ☐

v. Other.....

SECTION B: THE ASSOCIATION BETWEEN STOCK-BASED COMPENSATION AND EARNINGS MANAGEMENT

Please respond to the statements in the table below by ticking (√) in the appropriate column.

No.	Statement	Strongly Disagree (1)	Disagree (2)	Undecided (3)	Agree (4)	Strongly Agree (5)
1.	Banks offering Stock-Based Compensation contracts to the executives tagged on financial performance experience cases of Earnings Management.					
2.	Executives' remuneration tagged on stock prices of a bank motivates the directors to manipulate earnings for personal enrichment.					
3.	Executives' remuneration tied on stock prices of encourages the directors to manipulate earnings to sort out personal problems and debts.					
4.	Executives' Equity-Based Compensation tied on financial performance of a bank provides incentives to the directors to manipulate earnings and conceal poor performance with an aim to continue earning excess remuneration.					

SECTION C: THE ASSOCIATION BETWEEN CASH COMPENSATION AND EARNINGS MANAGEMENT

Please respond to the statements in the table below by ticking (√) in the appropriate column.

No.	Statement	Strongly Disagree (1)	Disagree (2)	Undecided (3)	Agree (4)	Strongly Agree (5)
1.	The executives' basic salary does not provide the directors any motivation to manipulate reported earnings.					
2.	Executives' Cash Compensation provides enough justification for directors to restate financial reports.					
3.	Cases of bank's executive basic salary influencing directors to manipulate financial statements is common.					
4.	Executive cash compensation does not have any kind of association with earnings management in the bank.					

SECTION D: THE ASSOCIATION BETWEEN BONUS PAYMENT AND EARNINGS MANAGEMENT

Please respond to the statements in the table below by ticking (√) in the appropriate column.

No.	Statement	Strongly Disagree (1)	Disagree (2)	Undecided (3)	Agree (4)	Strongly Agree (5)
1.	Bonus payments tagged on financial performance of a firm motivates directors to choose accounting methods that increases the reported income of the firm at the end of the financial period.					
2.	Executive bonus payment contracts do not provide the directors any kind of motivation to manipulate financial statements.					
3.	Banks offering excessive bonuses creates a corporate culture of personal gains at the expense of shareholders' wealth.					
4.	Many firms in Kenya linked with manipulation of financial statements offers high executive bonuses.					

SECTION E: INDICATORS OF EARNINGS MANAGEMENT

Please respond to the statements in the table below by ticking (√) in the appropriate column.

No.	Statement	Strongly Disagree (1)	Disagree (2)	Undecided (3)	Agree (4)	Strongly Agree (5)
1.	Directors conduct improper revenue recognition using accounting standards to maximize their personal wealth tied on financial performance.					
2.	Directors understates banks' real expenses to increase reported earnings so that their executive compensation tied on financial performance can be assured.					
3.	Directors use available accounting methods to overstate profit so that their excess remuneration based on equity options or bonus payments can be guaranteed.					
4.	Directors overstates cash flows to increase the firm's reported earnings to receive more remuneration.					

THANK YOU VERY MUCH FOR YOUR CO-OPERATION

PLEASE CHECK IF YOU HAVE ANSWERED ALL THE QUESTIONS

Appendix V: List of Commercial Bank included in the sample

No	Bank Name
1	KCB Bank Kenya Ltd
2	Equity Bank Kenya Ltd
3	Co - operative Bank of Kenya
4	Standard Chartered Bank (K) Ltd
5	Diamond Trust (K) Ltd
6	Barclays Bank of Kenya
7	Commercial Bank of Africa
8	Stanbic Bank Kenya Ltd
9	I & M Bank Ltd
10	NIC Bank PLC
11	Bank of Baroda (K) Ltd
12	Citibank N.A Kenya
13	National Bank of Kenya Ltd
14	Prime Bank Ltd
15	Family Bank Ltd
16	Bank of India
17	HFC Ltd
18	Ecobank Ltd
19	Bank of Africa (K) Ltd
20	Guaranty Trust Bank Ltd/Fina Bank
21	Victoria Commercial Bank Ltd
22	African Banking Corporation Ltd
23	Sidian Bank Ltd/K-Rep Bank
24	Habib A.G. Zurich
25	Guardian Bank Ltd
26	Credit Bank Ltd
27	Development Bank of Kenya Ltd
28	M Oriental Commercial Bank Ltd
29	Transnational Bank Ltd
30	Consolidated Bank of Kenya Ltd
31	Paramount Bank Ltd
32	Spire Bank Ltd/Equatorial Commercial Bank
33	Middle East Bank Kenya Ltd
34	SBM Bank (Kenya) Ltd / Fidelity Commercial Bank Ltd

Source: Central Bank of Kenya: Bank Supervision Annual Report, 2018