FACTORS AFFECTING THE QUALITY OF FINANCIAL REPORTING OF COUNTY GOVERNMENTS IN KENYA

BY

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DECLARATION

I declare that this is my original work and has not been previously published or submitted in any other University for academic credit.

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LIST OF ABBREVIATIONS

FRQ -	Financial Reporting Quality
IASB -	International Accounting Standards Board
FASB -	Financial Accounting Standards Board
PFM -	Public Finance Management
ICPAK-	Institute of Certified Public Accountants of Kenya
UK -	United Kingdom
IMTA -	Institute of Municipal Treasurers and Accountants
AAEA -	Association of Accountants in East Africa
SID -	Society for International Development
IAS -	International Accounting Standards
IPSAS -	International Public Sector Accounting Standards
COA -	Chart of Accounts
IPSASB-	International Public Sector Accounting Standards
PSASB-	Public Sector Accounting Standards Board
IFRS -	International Financial Reporting Standards
IFMIS -	Integrated Financial Management Information System
PAT -	Positive Accounting Theory
KASNEB-	Kenya Accountants and Secretaries National Examination Board
CPA -	Certified Public Accountant
UNDP -	United Nations Development Program
HDI -	Human Development Index
COSO -	Committee of Sponsoring Organizations

AICPA-	Certified American Institute of Public Accountants
ICAEW-	Institute of Chartered Accountants of England and Wales
DFID -	Department for International Development
PWC -	Price Waterhouse Coopers
IA -	Internal Audit

OPERATIONAL DEFINITION OF TERMS

Financial Reporting

Financial reporting refers to the preparation of financial statements (also called financial reports or accounts) of an entity or entities, within a framework of financial accounting concepts and standards. The resulting document set typically includes a balance sheet, statements of cash flows, income statement (also known as a profit and loss statement), a statement of retained earnings, along with supplementary notes, and may also include management comments such as a directors' report, and (where appropriate) an auditor's report (ACCA, 2015).

Financial statements

Financial statements are set of accounts prepared by the accounting officer of a given entity at the end of each accounting period. They include Appropriation accounts, statement of entity's debt outstanding at the end of each financial year, statement of entity debt outstanding at the of each year, statement of entity debt guaranteed by the National Government as at the end of the financial year, statement of the entity's assets and liabilities in respect of the Recurrent Vote, Development Vote and funds and deposits, statement of the accounting policies followed in preparing the financial statement and a statement of the national entity's performance against predetermined objectives (Act of Parliament: Public Finance Management Act, 2012).

Financial reporting quality

The accuracy with which a company's reported financials reflect its operating performance and their usefulness for forecasting future cash flows (CFA Institute, 2015).

Audit

Audit is a systematic review or assessment of something. (Oxford dictionary online, 2017) This generic definition faces a new reality due to recent management changes focusing management systems integration in organizations. A more suitable definition is provided by management standards stating that an audit is a 'systematic, independent and documented process for obtaining audit evidence and evaluating it objectively to determine the extent to which the audit criteria are fulfilled'.

Audit Opinion

Audit opinion is a written statement describing an auditor's independent, unbiased and qualified evaluation of the accuracy and completeness of a company's financial statements and practices, as well as an evaluation of a company's compliance with Generally Accepted Accounting Principles (GAAP). (Business Dictionary, 2017)

Qualified Opinion

This refers to an autonomous auditor's judgment given as a component of audit account indicating; the audit was controlled in capacity otherwise the fiscal reports present reasonably the fiscal situation of the firm, or else the audit was unlimited and for the complete accounting phase but an unprofessional judgment cannot be uttered since the account books and account do not entirely reflect circumstances that match to the requirements of the Generally Accepted Accounting Principles (Business Dictionary, 2017).

Unqualified Opinion

Independent Auditor's pronouncement that he or she has no hesitation in endorsing that the inspected firm's fiscal reports sufficiently reveal material date, present reasonably its fiscal situation, and illustrate outcomes of its business in agreement with the requirements of Generally Accepted Accounting Principles, as well called the clean opinion (Business Dictionary, 2017).

Internal Controls

The Turnbull Report, first published in 1999, defined internal control and its scope as follows:

‘The policies, processes, tasks, behaviors and other aspects of an organization that taken together: Facilitate effective operation by enabling it to respond in an appropriate manner to significant business, operational, financial, compliance and other risks to achieve its objectives. This includes safeguarding of assets and ensuring that liabilities are identified and managed.

ABSTRACT

Demand for transparency and accountability in Kenya's county governments and public sector in general has been piling up in higher magnitudes. Quality, transparent and comprehensible financial information is important for the county governments to express their accountability to Kenya's general public and development partners who finance various undertakings in the county governments. Quality financial data is requisite for in house financial management and decision making. This study endeavored to study the factors influencing the quality of financial reporting of county governments in Kenya. The study objectives included finding the effect of staff capacity, IFMIS, top management expertise and internal audit quality on the quality of financial reporting. This study adopted descriptive research design where data was collected by use of questionnaires. The target population was the accounting officers for finance for the 47counties in Kenya. Data collected was analyzed using both quantitative and qualitative methods and by use of descriptive analysis and content analysis respectively. The researcher performed exploratory research to find out whether county governments staffing capacity needs has been assessed and that the counties have the right staff for the right job; the top management of the county governments support quality financial reporting and use of IFMIS system. The study performed regression analysis to test the relationship of each of the four independent variables to the quality of financial reporting. Analyzed data was presented in form of tables and explanations given for each of the tables. The study found out that counties have effective and efficient recruitment systems in place and that staff were best suited to perform the job. Top management professional background and previous experience has significant influence on the quality of financial reporting according to the study. IFMIS system was found to be reliable in the production of financial data for reports preparation. The regression analysis revealed that staff capacity significantly influenced the quality of financial reporting. All the other three variables, had an influence on the quality of financial reporting but not as significant as staffing capacity. The study revealed that adequate training on IFMIS system is necessary for the attainment of quality financial reporting. The study recommends regular trainings on IFMIS system and PFM laws and regulations to enhance compliance in financial management and reporting in the public sector.

Key words: Financial reporting, financial reporting quality, county governments, audit opinion, internal audit.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Financial reporting quality is a subtle concept in accounting literature, hence, there is no consensus so far among researchers on how best to define and measure it. McDermott (2011); Biddle et al., (2009); Nasser and Nuseibeh (2003); Robinson and Munter (2004) define financial reporting quality as the precision with which financial reporting conveys information about the firm ‘s operations or compliance of accounting standards of a particular country, or the extent to which the published financial statements and related disclosures capture the essence of the operations and financial position of the reporting entity. However, IASB (2008) defines FRQ in-terms of the fundamental and enhancing qualitative characteristics underlying decision usefulness. These definitions are consistent with the Financial Accounting Standards Board (FASB) since they are all concerned with the manner in which financial accounting information is presented to the stakeholders. In a broader perspective FRQ may be regarded as a rational approach of an individual user of financial statements since different user groups have dissimilar preferences, therefore perceived quality will deviate from each user group.

Biddle and Hillary (2006) and Lambert et al. (2007) suggest that financial reporting quality is determined from a number of perspectives namely; earnings, persistence, timeliness, disclosure quality, audit fee charged, compliance with international financial reporting standards and earnings management. These measures of FRQ only focus on attributes believed to influence quality of financial information, hence indirectly measure the level of FRQ. Going by literature on measures of financial reporting quality there is evidence that some models are not comprehensive measures of reporting quality. Vantendeloo&Vansstrealen (2005) argue that accrual models only use financial information; hence exclude non-financial information from annual reports of firms. This model has been used in most of the empirical studies dealing with Financial Reporting Quality (FRQ).

IASB (2010 paragraph QC4) states that, if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of the financial information is enhanced if it is comparable, verifiable and understandable. However, in the wave of recent scandals and loss of billions of shillings of investments in state corporations in Kenya, e.g. National Youth Service Scandal and The Health Ministry free maternity funds scandal, the very integrity and representation of value relevance, timeliness in reporting and disclosure quality has been called to question.

The existing literature reports inadequacies in public sector accounting and financial management performance in the developing world (Blondal, 1998; Craner& Jones, 1990; Dean, 1988; 1989; Ghartey, 1985). Very often poor countries are poor in financial management performance, which has made financial management decision-making unrealistic and inconsistent (Blondal,1988). Proper accounting data and interpretation thereof is very much needed for sound, economic and proper management decisions (Gujarathi & Dean, 1993). Many studies point to the deficiency in accounting systems as an important weakness in the management of the public sector of most, and especially, developing countries (Blondall, 1988; Craner& Jones, 1990; Deen, 1988; 1989; Ghartey, 1985). Further deficiency in accounting systems is the main reason or improper, inaccurate and delayed financial information communication. ‘Deficiency’ in public sector accounting and financial management systems has been identified as a characteristic of socio-economic underdevelopment (Enthoven, 1988; Craner

& Jones, 1990). Further, poor countries generally have poor governmental accounting and financial management systems (Dean, 1989).

The government of Kenya in particular has for a long time been very much concerned over the persistent poor performance in financial management due to lack of reliable and timely information for decision making. A review by the department of accountant general at treasury, financial management, accounting systems and role of audits revealed weaknesses in the management of financial information. The review focused on the need to develop a strategic plan aimed at improving the financial management systems; skills and capacity within the government financial operations units. It also reviewed how timeliness of financial information, if improved, could form the basis for improving control of expenditure against budget (Kinyua, 2003).

Kenya then adopted International Accounting Standards (IAS) in the year 2000 through the Institute of Certified Public Accountants of Kenya (ICPAK). The standards were however largely used by the private sector. The public sector relied largely on accounting principles which were not standardized across the sector. In 2008 the then minister for Local Government issued a directive for all Local Authorities to adopt International Public Sector Accounting Standards (IPSAS). However, there was no clear mechanism to implement the same. Some public sector entities adopted IFRS while others summarized the government chart of accounts (COA). This non-uniformity made it difficult for the Auditor General to audit public sector entities as it was not clear what constituted annual financial statements. This necessitated the harmonization of reporting in the public sector in Kenya. (IPASB, 2016)

Kenya's public sector has undergone public financial management reforms in a bid to make public financial management more efficient, effective, participatory and transparent resulting in improved accountability and service delivery (Society for International Development, 2012).

The public sector accounting standards board was established as part of Public Financial Management (PFM) reforms in Kenya following the promulgation of the new Constitution 2010 and the subsequent enactment of the Public Finance Management (PFM) Act in 2012. The PSASB is a statutory standard setting body established under the PFM Act 2012.

1.1.1 County governments in Kenya

County governments in Kenya refer to the 47 counties created by the constitution of Kenya (CoK, 2010) under the system of devolved governance. The number is based on based on the delineation of administrative districts as created under the provinces and Districts Act of 1992. They are made up of the county assembly and the county executive. The financial management and reporting of all county governments is guided by various laws, key among them being the CoK 2010, and the Public Finance Management Act (2012). The CoK 2010 under article 201 for example gives among other provisions the principles that should govern all aspects of Public Finance in Kenya.

1.1.2 Factors influencing the quality of financial reporting

Researchers have argued on a number of factors that tend to influence the quality of financial reporting in any organization. Vander Bauwhede (2001) states that potential factors which influence the quality of financial statements are: management decisions, quality of external management mechanism (e.g. audit quality), quality of internal management mechanism (e.g. quality of board of directors), and regulations as well as mechanisms of external and internal managements. Use of computerized technology, staff professional exposure and internal training contribute to quality financial reporting in Kenya's banking sector (Tarus et. al, 2015).

Factors which were investigated in this study included staff capacity, top management expertise, Integrated Financial Management Information System (IFMIS) and internal audit quality. The factors are considered to influence the quality of financial reports particularly in Kenya's county governments. Groot and Molen (2000) defined capacity building as the development of knowledge, skills and attitudes in individuals and groups of people relevant in design, development, management and maintenance of institutional and operational infrastructures and processes that are locally meaningful. This is a broader approach while still focusing mainly on education, training and human resource development. Therefore, based on this definition, capacity building for employees in a broad sense may refer to improvements in the ability of all employees to perform appropriate tasks within the broader set of performance standards of the organization. Capacity development is indispensable component of human resource if organizational goals are to be achieved (Canadian Social Science, 2013).

IFMIS is an automated system that enhances efficiency in planning, budgeting, procurement, expenditure management and reporting in the National and County Governments in Kenya. The International Monetary Fund (IMF) had carried out a survey in government accounting in early 1993 followed by a diagnostic study sponsored by the World Bank; this led to introduction of IFMIS. The main objective of this project was to computerize the whole accounting and auditing system in the country. The idea behind computerizing the whole system was generation of accurate and reliable financial statements; to monitor fiscal deficit; to forecast flow of cash; to manage public debt and to achieve effective financial controls (Kinyua, 2003).

The old accounting system lacked timeliness, accuracy and most importantly transparency. Accounts of any organization, large or small, are the most important tool for curbing the corruption by keeping an eye on cash flows and more importantly to give the overall inner picture of the organization to the stakeholders which helps them take informed decisions (Kearney, 2004). This study is therefore focused to finding out the effect of this system on the quality of financial reporting of county governments in Kenya.

The purpose of internal audit function is to institute an internal control system that promotes effectiveness and efficiency in all activities, reliable financial statements, asset safety, fidelity towards laws and regulations. Internal control system is needed in order to ensure the achievement of organizational goals. (Journal of research in business and management, 2014) Documented evidence indicates that internal audit function has a significant impact on financial reporting in terms of detecting and preventing fraud (Church et al., 2001; Coram et al., 2008). Other evidence indicates that Internal Audit Function has an important role in completing the financial statements audit (Abdel-Khalik et al., 1983; Felix et al., 2001; Zain et al., 2006; Ward and Robertson, 1980), implying that Internal Audit Function has an effective role in improving the audit quality and in turn Financial Reporting Quality.

The effectiveness of the internal audit function in performing the above roles is tagged on its quality. Prawitt, Smith, and Wood, 2009 is the first archival study to link IAF quality to financial reporting quality. Recent studies have examined the impact of different governance mechanisms on the transparency and quality of financial reporting. However, few studies have investigated the relationship between internal audit and financial reporting quality (Al-Shetwi et al., 2011). This study seeks to establish the effect of internal audit quality on financial reporting quality as one of its specific objectives. The study intends to achieve this objective by measuring audit quality in terms of timeliness of internal audit reports, average experience of internal audit staff and size of internal audit unit.

Top management plays a key role in the financial management and reporting of every organization. The constitution of Kenya, 2010 under the Public Finance Management Act, 2012, Section 148 gives powers to the County Executive member for finance to designate the accounting officers to be responsible for managing the finances of the county government entities as is specified in the designation. Sec 149 (2) of the PFM Act 2012 requires the accounting officer to, not later than three months after the end of each financial year, prepare annual financial statements for that financial year and submit them to the Auditor-General for audit, with a copy to the County Treasury. This is therefore a clear indication that the responsibility for preparation of financial statements rests with the accounting officers for each of the county government entities.

The accounting officers serve as chief executive officers for each of the county government entities. In the management literature, upper echelons theory finds that corporate actions and strategic choices are partially predicted by the functional background of executives (Hambrick and Mason 1984, Thomas et al., 1991, Hambrick, 2007). A growing segment of the empirical literature in economics, finance and accounting shows that individual executives affect corporate outcomes (Bertrand and Scholar, 2003; Chava and Purnanandam 2010; Bamber et al., 2010; Ge et al., 2011; Ding, 2011).

1.1.3 Financial Reporting of County Governments in Kenya

Financial reporting in the county governments faces challenges because of unreliable information systems making it difficult to ascertain the completeness of revenue (e.g. parking fees), Lack of capacity to handle the financial complexities (inadequate staffing, inadequate skills, inability to attract the best talents in financial management), Frequent staff transfers of key accounting officers, Political interferences of procurement and staffing, Weak governance structures for financial controls and reporting and inappropriate historical culture for financial reporting (ICPAK, 2013).

The Constitution of Kenya 2010 has introduced fundamental changes in the way public finances are managed. These changes had, unfortunately, received little or no attention prior to the referendum and the subsequent promulgation of the Constitution in August 2010 (Kirira, 2011). Prior to the enactment of the constitution 2010, the Public Finance Management Act No. 5 of 2004 aimed at streamlining the government financial affairs in Kenya and provided for persons to be responsible for government resources. This act was later repealed by the Public Finance Management Act No. 18 of 2012. PFM Act, 2012 is meant to provide for effective management of public financial resources in the national and county levels of government.

The constitution of Kenya under the Public Finance Management Act of 2012, Section 163 requires the county governments to prepare annual financial statements. Section 163 (1) requires the county treasury to consolidate the annual financial statements in respect of all county government entities in the formats prescribed by the Accounting Standards board from time to time. Section 64 (1), requires the accounting officer of a county government entity to prepare annual financial statements which includes an appropriation account showing the services for which the appropriated money was spent, amounts actually spent on each service, status of each vote compared with the appropriation for the vote, statement explaining any variations between the actual expenditure and the sums voted and any other information specified by the county treasury. Other statements to be included in the list as per PFM Act 2012 Sec 164 (1) include the statement of entity's assets and liabilities, a statement of accounting policies followed in preparing the financial statements and a statement of county entity's performance against predetermined objectives among others.

The PSASB through a gazette notice No. 1554 dated 18th August 2014, signed by the Cabinet secretary on 8th July 2014, adopted International Public Sector Accounting Standards (IPSAS) and International Financial Reporting Standards (IFRS) for use by the public sector entities. Retrospective application for the year ended June 2014 was encouraged by International Public Sector Accounting Standards Board (IPSASB). The National and County governments are therefore obligated to comply with this notice and apply International Public Sector Accounting Standards (IPSAS) cash basis on their financial reporting.

According to the International Public Sector Accounting Standards Board (IPSASB, 2015), adoption of IPSAS and IFRS has improved public sector financial reporting through uniformity in the application of accounting standards, capacity building of staff by the IPSASB and involvement of stakeholders like ICPAK in the Public Sector Financial Reforms.

However, according to the Auditor General, county governments in Kenya for the financial year 2013-2014, 100% of the financial statements audited had a disclaimer of opinion. This trend has continued in the 2014-2015 financial year while in 2015-2016 six county governments had a qualified audit opinion while the rest had a disclaimer of opinion. This is a clear indication that county governments in Kenya have struggled to report adequately on their financial matters.

The county governments in Kenya are founded under the Constitution of Kenya 2010. The set-up of the county governments is the same in terms of policies and guidelines they use in financial reporting. The National treasury policy documents and the Public Finance Management Act, 2012, spell how public finances are managed in the counties as well as the framework for financial reporting.

1.2 Statement of the Problem

Quality financial statements help the government in making upright decisions that uphold the interest of the public. Owing to the high requirements for public accountability in Kenya's public sector, preparation of transparent and comprehensible financial statements and other annual accounts is an essential means for government agencies to exhibit their accountability to the general public who finance them through taxes and development partners who frequently donate to the development activities of the government (Pricewaterhousecoopers, 2012).

Financial reporting systems have faced challenges in developing countries despite reforms in some of these countries (Public and Financial Handbook, 2008).Although the government of Kenya has put in place financial regulations and procedures, together with the enactment of the Act of parliament: Public Finance Management Act, 2012 to act as a guide in financial management practices, much has not been done to address the inadequacy of public sector financial reporting. Kenya's Auditor General has consistently passed adverse opinions on the quality of accounting records and financial reports (ICPAK, 2013).

According to Kirira, 2013, if the issue of inadequate financial reporting is not treated with the seriousness it deserves and the problems fully addressed, the Kenya public sector will not be able to attain the set standards for public accountability and transparency as contained in the Act of parliament, Public Finance Management Act, 2012. This will open room for litigation by any taxpayer in Kenya on the basis of non-compliance and donors may also hold back funds citing non-compliance with agreed policies.

Financial statements are used by various stakeholders. Some of these stakeholders (such as creditors) have superior knowledge in assessing the quality of financial statements and can impose costs on the firms (e.g. through less favorable terms of trade) if they consider that the financial statements are of low quality. Also any detection by the stakeholders that the organization did not follow the recommended standards of financial reporting may result in loss of trust between the stakeholders and the organization (Heidi, 2001).

Few studies have focused on financial reporting of county governments in Kenya.Lugwe I.M, 2016 in her study of factors affecting finance management of devolved units in Kenya: A case study of Kwale county government found out that record keeping which is key to quality financial reporting of the county governments, affects financial management of devolved units in Kenya. Lugwe however did not point out the factors affecting record keeping by the devolved units and hence the quality of financial reporting.

According to Onyango R.O., 2014 in his study of influence of internal controls on performance of county governments in Kenya, financial reporting influenced the performance of county governments in Kenya. His regression analysis showed that a unit increase in reporting will lead to 0.752 performance of the county government. Though his study appreciates the value of financial reporting of the county governments to its performance, it does not bring out the factors affecting the quality of financial reporting of county governments in Kenya.

According to Nyamasege et. al., 2016, in their study of effect of internal control systems on implementation of projects at county governments in Kenya, incorrect and unreliable financial records are leading to loss of organizational integrity, therefore affecting the implementation of projects at county governments in Kenya. Mungai and Naiseku2015 in their study of factors affecting budget execution by county governments in Kenya also cited inadequate reporting on public funds to be the cause of sub-optimal performance in budget execution by county governments in Kenya. Although these studies cite inadequate financial reporting as contributing to sub optimal budget execution by the county governments and implementation of projects, they do not study the factors affecting the quality of financial reporting of county governments in Kenya. It is in light of this background of insufficient studies focusing on the factors affecting the quality of financial reporting of county governments in Kenya that this study draws its research gap.

1.3 Objective of the study

The overall purpose of this study is to find out the factors affecting the quality of financial reporting of county governments in Kenya.

1.3.1 Specific Objectives

1. To assess the effect of staff capacity on the quality of financial reporting of county governments in Kenya
2. To assess the effect of top management expertise on the quality of financial reporting of county governments in Kenya.
3. To assess the effect of Integrated Financial Management Information System (IFMIS) on the quality of financial reporting of county governments in Kenya.
4. To assess the effect of internal audit quality on financial reporting quality of county governments in Kenya.

1.4 Research questions

1. How does staff capacity influence the quality of financial reporting of county governments in Kenya?
2. How does top management expertise affect the quality of financial reporting of county governments in Kenya?
3. How does Integrated Financial Management Information System (IFMIS) influence the quality of financial reporting of county governments in Kenya?
4. How does internal audit quality influence the quality of financial reporting of county governments in Kenya?

1.5 Significance of the study

This study is significant to Public sector stakeholders in Kenya as well as various scholars for purposes of reference.

1.5.1 Kenya's Public Sector

The Kenya public sector and in particular the county governments will benefit from this study to strengthen the finance functions in the county governments in order to achieve accountability, quality record keeping and financial reporting.

1.5.2 Institute of Certified Public Accountants Board (ICPAK)

This study will be beneficial to ICPAK in identifying areas of training need in the accounting profession in order to boost the performance of its members.

1.5.3 International Public Sector Accounting Standards Board (IPSAB)

This study will be of value to the International Public Sector Accounting Standards Board; IPSASB will make use of this study to improve on financial reporting guidelines and templates in order to improve public sector financial reporting and particularly in the county governments.

1.6 Justification of the study

There is overwhelming demand by the public in Kenya for adequate accountability and transparency in the management of public resources. Kenya depends solely on tax payer's money, loans from international financial institutions like World Bank and donor funds in funding its annual expenditure budget.

In Kenya with the passing of the Constitution in 2010 and leading to the establishment of 47 other governments, resources have now been devolved to the county governments. There has been general outcry in the public about the management of financial resources in the county governments with the recent publication of counties buying goods at prices higher than the market prices.

Management uses financial statements to communicate to its stakeholders about their management of financial and non-financial resources. Financial statements therefore attract many users from taxpayers, donors and lenders and other general public. It is therefore paramount that financial statements are of quality as they portray the information necessary for the public to hold the government accountable. This study therefore seeks to identify the factors influencing the quality of these financial statements of the county governments in Kenya.

1.7 Scope of the study

The study is limited to the factors influencing the quality of financial reporting of the selected counties in Kenya. The study will be a descriptive study carried out by collecting data relating to the independent variables, through questionnaires and analyzing the same using SPSS software. The target population will be the accounting officers for all the county governments in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviewed the literature related to the study on the topic of establishing the factors that influence the quality of financial reporting of county governments in Kenya. This is followed by the following study objectives: How does staffing capacity influence the quality of financial reporting? How do Integrated Financial Management Information System (IFMIS) influence the quality of financial reporting? How does internal audit quality influence the quality of financial reporting? How does top management expertise influence the quality of financial reporting? A conceptual framework is used to operationalize the variables and lastly the gaps in literature are summarized.

2.2 Theoretical Framework

The theoretical framework is based on the theories below.

2.2.1 Positive Accounting Theory (PAT)

Positive Accounting Theory (PAT) was developed by Watts and Zimmerman in 1978 and 1986 with a view of seeking to predict and explain why managers have a preference for given accounting methods (Sugut, 2014). PAT explains why accounting is what it is, why accountants do what they do and what effects these phenomena have on people and resource utilization (Mutai, 2014). Abdulrazak (2013) argues that PAT is the reason for the choice of accounting methods, techniques and policy decisions. The organization is described by PAT in the form of collection of contracts that are necessary to help self-seeking individuals agree to cooperate such as employee contracts etc. (Mutai, 2014).

According to PAT, the information can be distorted based on the management motive in several ways (Oluoch, 2014). The management has information advantage over other stakeholders and may seek to influence the reporting of earnings and capital structure in financial reports due to conflict of interest between the managers (agents) and owners of the firm (principals). PAT therefore seeks to explain the manager's choice of accounting methods in terms of self-interest and relationship between stakeholders. This theory is relevant to this study because it explains why preparers of financial statements will pick one accounting method over the other. Complex accounting concepts and policies, compliance to applicable accounting standards e.g. IPSAS cash basis for the county government calls for continuous staff capacity development to keep abreast of the dynamic organizational environment.

2.2.2 Technology Acceptance Model (TAM)

While Theory of Reasoned Action (TRA) and Theory of Planned Behavior (TPB) mainly focus on the adoption and use of Information Communication Technology (ICT), the Theory of Acceptance Model (TAM) explains the determinants of user acceptance of a wide range of end-user computing technologies. TAM identifies two theoretical constructs including Perceived Usefulness (PU) and Perceived Ease of Use (PEOU) that affect the intention to use a system. There are a number of studies that have used Technology Acceptance Model (TAM) as their theoretical background for explaining ICT adoption and use. Scholars have already confirmed that Perceived Usefulness (PU) has a positive relationship with both adoption intention (Davis, 1989) and continuance intention (Ritu and Agarwal, 2000).

In post adoption studies, Perceived Usefulness (PU) has been found to influence satisfaction (Anol, 2001; Moez, Hirtand Cheung, 2007) and attitude towards the technology (Anol and Hikmet, 2008). Perceived Ease of Use (PEOU) has been found to influence both PU and adoption intention (Davis, 1989). Even though TAM was found to be a valid theoretical framework in studying ICT adoption and use, it has been criticized for its several limitations including the original model's intended generality and parsimony (Dishawand Strong, 1999), not considering non-organizational setting (Venkatesh and Davis, 2000), and overlooking the moderating effects of ICT adoption and use in different situations (Sun &and Zhang, 2006).

This theory is relevant to the adoption and effective use of IFMIS in the county governments which is one of the objectives of this study. Perceived Usefulness and Perceived Ease of Use are two theoretical constructs likely to influence the effective adoption of IFMIS in the county governments.

2.2.3 The Upper Echelons Theory

Upper Echelons Theory (UET) was founded on the premise that organizational outcomes are directly impacted by the knowledge, experiences and expertise of those individuals occupying prominent managerial roles in the organization (Hambrick& Mason, 1984). These authors introduced a model in which situations occurring in the context of organizational life are addressed by managers whereby strategic choices are made as a function of the unique characteristics these individuals exhibit. As a result of the choices made by these individuals, organizational performance is argued to be directly impacted. To reconcile the impact that these "upper echelons" have on organizational performance, Hambrick and Mason (1984) argued that focus should be directed towards those data readily observable reflecting individual characteristics with respect to the educational, professional, and social backgrounds of prominent managers in organizational contexts.

To apply Upper Echelons Theory (UET) effectively to examine organizational performance, the issue of causality is an important consideration (Hambrick& Mason, 1984). First, those managers with significant professional experience within an organization or industrial context come to act in accordance with these previous experiences more so than on the basis of their individual attributes. Strategies employed in organizational life as a function of executive decision making are often a function of macro forces driving the pursuit of organizational goals. For example, an executive who is newly hired from an outside firm may bring a different perspective to the decision making process than an individual promoted from within the organization to the position of manager. Thus, identifying the forces most directly driving the decision making process are important in Upper Echelons Theory (UET) research.

While the Top Management Team (TMT) has been defined as executive managers who also serve on the board of directors (Finkelstein &Hambrick, 1990), most extant Upper Echelons Theory (UET) applications define the Team Management Team (TMT) based on convenience (Carpenter et al. 2004). As demographic data on TMT employees typically are collected via public sources such as annual reports, most Upper Echelons Theory (UET) studies define the TMT as those individuals operating at the highest levels of management such as the Chief Executive Officer (CEO), Chief Operating Officer (COO), and Human Resources Director. Thus, the definition of the TMT in UET research is fluid from study to study as scholars have tended to utilize data on those executives identified in public information sources in developing and testing hypotheses.

This theory is relevant to this study in the sense that it explains how managers experience, expertise and knowledge influences the choices they make over different organizational matters. In the context of this study, the researcher seeks to find out the relationship between top management expertise and the quality of financial reporting.

2.3 Empirical Literature

Most researches have noted insufficient financial reporting in the public sector attributed to various inadequacies of competent personnel, suitable framework for public sector accounting, managements with adequate skills to perform its responsibilities and inadequate accounting systems in place among others.

2.3.1 Staff Capacity and the quality of financial reporting

Many Countries in Africa have fewer than 100 professionally qualified accountants and they are normally deployed in the private sector. Countries like Angola, Mauritania have only 1 qualified accountant each, Mozambique has 2, Mali 5, Eritrea 7, and Sierra Leone 91 and (Ethiopia second largest country in Africa) has less than 300 qualified accountants. (World Bank, 2007)

A study carried out in Kenya by the United Nations identified that the majority of the accountants in Kenya complete KASNEB but fail to register for membership yet ICPAK provides current guidance pertaining new standards through its members. This implies that most of the preparers of financial statements do not have up to date information concerning development in the profession. (Outa, 2011).

NurAffiah and Rahmatika, 2014, on their paper; Factors influencing the quality of financial reporting and its implications on government governance found their results consistent with previous research. Competence of personnel in financial management, especially in the government sector is very important. Apparatus inability to handle financial management, lack of background in accounting will lead to the inability to analyze the financial statements or the inability to understand the internal accounting reports (Rita H.Cheng, 2002). Furthermore, NurAffiah (2004) simultaneously and partially stated legislators competence, the competence of local government bodies, implementation of accounting information systems, budgeting and financial information quality affect the principles of good governance. In line also with Hood and Lodge (2004) analyzed the competence of the senior civil servants at the national level in the three countries (USA, UK and Germany), Competence considered as a central theme in public service reform, so by tracing the development of competence as a show idea that reform competency describes the selective ideas in management and public services in order to achieve good governance. This study also reinforces with Palmer, Kristine N et al (2013) bring the competence related to the quality of financial statements.

To improve public sector financial reporting and accountability in the short to medium term, countries need a critical mass of trained personnel at the technical and higher levels. Countries need to have a system of accreditation that can produce qualified Financial Management personnel (accountants, auditors, public finance managers etc.) in order to meet public and private sector demands on a long term sustainable basis. (World Bank, 2007).

2.3.2Internal audit quality and financial reporting quality

In 1978, the Institute of Internal Auditors (IIA) defined internal auditing as:

"An independent appraisal activity established within an organization as a service to the organization. It is a control, which functions by examining and evaluating the adequacy and effectiveness of other controls. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed" (Ali et al., 2007)

Griffiths" study (1999) within 92 FTSE 200 companies reveals that financial director's perception of internal audit is by no means universally positive. However, their main concerns were that the function was too low key and basic (and therefore insufficiently operationally or business risk oriented) or that the function was lacking in skills (or had a poor mix of skills/staff). Following the financial directors in his study, internal audit needs to become much more business (risk) and operationally oriented, be more proactive, responsive and innovative and enhance the skills within the function as well as the quality of the staff.

Some research results show that internal audit quality is related to the increase of financial reporting quality (Al-Shetwi et al., 2011). Nuraini A., 2015, on his paper; the role of corporate governance on financial reporting quality (Evidence from Indonesia Stock Exchange), has found a correlation between internal audit quality and the quality of financial reporting from their study.

Marius and Wallek, 2016, carried out a study to determine the relationship between internal audit function and financial reporting of German listed companies. Their results showed that a high-quality Internal Audit Function (IAF) is able to contribute to both financial reporting quality and audit efficiency. Their findings support the notion that the Internal Audit Function (IAF) serves as an essential element of effective corporate governance and plays an important role in financial reporting. Moreover, as a practical implication of interest to regulators and managers, they identify that the external certification of the IAF and internal audit-related certifications of IAF employees may contribute to higher financial reporting quality and lower audit fees.

Prawitt, Smith, and Wood, 2009 used a single, additive composite, comprising of equally weighted metrics representing experience, certification, training, IAF reporting structure, time spent on financial activities, and relative IAF size to measure IAF quality. Using data from 2000 to 2005, the authors found that their composite measure of IAF quality is associated with mitigation of income decreasing accruals, but not income-increasing accruals. When they disaggregate their IAF characteristics, they find positive relationships between financial reporting quality and the IAF's professional certifications (income-decreasing accruals) and IAF size relative to industry (income increasing accruals). Prawitt, Smith, and Wood, 2009 do not however find significant associations between the IAF independence characteristic (whether the IAF reports to the audit committee) and financial reporting quality. While their composite measure of IAF quality includes facets of competence and independence, it is unclear when both of these characteristics are present for a given firm and whether their relationship is interactive or additive.

2.3.3Integrated Financial Management System (IFMIS) and the quality of financial reporting

In 2003, the UK's Department for International Development (DFID) issued its guide on public expenditure management which noted that, in recent years, there has been a dramatic surge of interest in public expenditure issues amongst governments, development agencies and the wider public. This shift was seen in the eyes of World Bank to offer Africa a chance to leapfrog intermediate stages of development (DFID, 2003). As a result, consultants and other advisors of governments in Africa started toying with the idea of the introduction of modern information technology, the Integrated Financial Management Information Systems -IFMIS (World Bank, 2004).

Salehi and Elahe, 2012, in their research paper; The role of Information Technology in Financial Reporting Quality: Iranian scenario, have found that the use of IT has considerably changed financial reporting, especially as regards the relevance of accounting information; it is mainly because the use of IT (particularly the Internet, its instruments and protocols or soft ware formats based on that) has resulted in on-line financial reporting in which IT can help users make better economic and managerial decisions. By increasing the relevance of information, some of these technologies and the way that they affect decision making (and consequently affect relevance) include: databases (for analyzing data), professional systems (help in analyzing deviations, debt and risk analysis), neuron networks (as prediction tools), XBRL (making access to data easier for investors and analysts, a powerful instrument for correct exploitation and assessment of data by users), information reservoirs (providing specific information for users), intelligent agencies (analyzing data and helping the decision- making process), soft ware for supporting decisions (helping decision-makers to analyze data and to substantiate decisions before selecting a decision) and superior communication (improving access to data).

However, the results of this research indicate that apart from various advantages of IT in financial reporting, its reliability is reduced due to two main reasons. The main reason is the lack of capacity for continuous accounting at the present time which is expected to improve with the advances in the IT sector. The other reason for decreased reliability is the security of information.

Moochi, 2012, in her dissertation; The effects of Integrated Financial Management Information System on Financial performance of state corporations in Kenya found out from the regression analysis that IFMIS practices have had a significant impact on the financial performance of state corporations in Kenya during the period under study. This was supported by the high Coefficient of Multiple Determination (R2 Square) of 0.843 and significance change of 0.001 implying that the impact of e-procurement practices is significant at 5% confidence interval. The most influential IFMIS practice was the Corporation's alignment of her goals to the overall public financial sector reforms with a regression coefficient of 0.170 and a P- value of 0.000.

The findings of her study thus concur with those of Dione (2013) in his study of the critical success factors in public financial management efficiency in the third world. In his study he found a near positive linear relationship between integrated financial management practices and financial efficiency in the public sector obtaining a coefficient of Multiple Determination (R2 Square) of 0.801 and P-value of 0.001.

2.3.4Top management expertise and the quality of financial reporting

The findings from the stream of research have linked the top management expertise to quality of firms' financial reporting. For example, Klein (2002) examines board member independence and audit committee independence and finds a positive association between the independence of both board members and audit committee members and firms' financial reporting quality. Similarly, Bedard et al. 2004 examine audit committee expertise, independence, and activity on aggressive earning management and find that directors with more expertise and independence are positively associated with higher financial reporting quality.

N. Omoro, J. Aduda, K. Okiro, 2015, in their paper, Demographic diversity in top management team and Financial reporting quality in commercial state corporations in Kenya; found that a unit change in education diversity of Top Management Team results into enhancement of financial reporting in state corporations in Kenya. The interpretation is that demographic diversity has significant effect on financial reporting quality of commercial state corporations in Kenya.

Leong et al., 2015, however, do not find that accounting experts with overlapping membership on audit and remuneration committee's matters for financial reporting quality. The theory by Lauxand Laux (2009) proposes that audit committee members sitting on remuneration committee shall know more on management's pay for-performance compensation package and hence better able to identify management's incentives to manipulate financial reporting. Our result indicates that the overlapping membership does not contribute to the monitoring of financial reporting quality. There might be a dilution of efforts by overlapping membership directors and hence there is no improvement in monitoring financial reporting process. In fact Liao and Tsu (2013) find that firms with overlapping membership have lower financial reporting quality.

2.4 Summary of Literature Review

The literature points out inadequacies in public sector financial reporting. This is notably high in developing countries. Weak accounting systems, lack of competent personnel in the accounting function, weak controls resulting from non-existence of internal audit functions or weak internal audit functions is mainly attributed to poor quality of financial reporting in the public sector.

In Kenya the Public Finance Management Act 2012, provides guideline as to public financial management practices. This has however not helped to improve the quality of financial reporting in Kenya as PricewaterhouseCoopers, 2012 confirms that Kenya's public sector financial reporting has been insufficient as government agencies do not keep clear reports. The reports have been intricate, perplexing and large.

From the literature most of the accountants in Kenya do not access training for continuous professional development, this has been attributed to the fact that most accountants complete professional exams (CPA) but do not enroll as members of the Institute of Certified Public Accountants of Kenya.

2.5 Research gaps

Few studies have focused on financial reporting of county governments in Kenya. I.M. Lugwe, 2016 in her study of factors affecting finance management of devolved units in Kenya: A case study of Kwale county government found out that record keeping which is key to quality financial reporting of the county governments, affects financial management of devolved units in Kenya. Lugwe however did not point out the factors affecting record keeping by the devolved units and hence the quality of financial reporting.

According to Nyamasege et. al., 2016, in their study of effect of internal control systems on implementation of projects at county governments in Kenya, incorrect and unreliable financial records are leading to loss of organizational integrity, therefore affecting the implementation of projects at county governments in Kenya. Mungai, and Naiseku, 2015 in their study of factors affecting budget execution by county governments in Kenya also cited inadequate reporting on public funds to be the cause of sub-optimal performance in budget execution by county governments in Kenya. Although these studies cite inadequate financial reporting as contributing to sub optimal budget execution by the county governments and implementation of projects, they do not study the factors affecting the quality of financial reporting of county governments in Kenya. It is in light with this background of insufficient studies focusing on the factors affecting the quality of financial reporting of county governments in Kenya that this study draws its research gap.

2.6 The conceptual Framework

The purpose of financial reporting is to provide accurate financial data to the central management of the organization and all other external stakeholders of the organization e.g. customers, creditors, shareholders and the government. Quality financial statements are therefore a central facet in which all the stakeholders rely in making economic decisions.

The study therefore conceptualizes that better staffing capacity and competency, level of IFMIS implementation and usage, internal controls and budgeting process as the independent variables will lead to quality financial reporting by the entity.

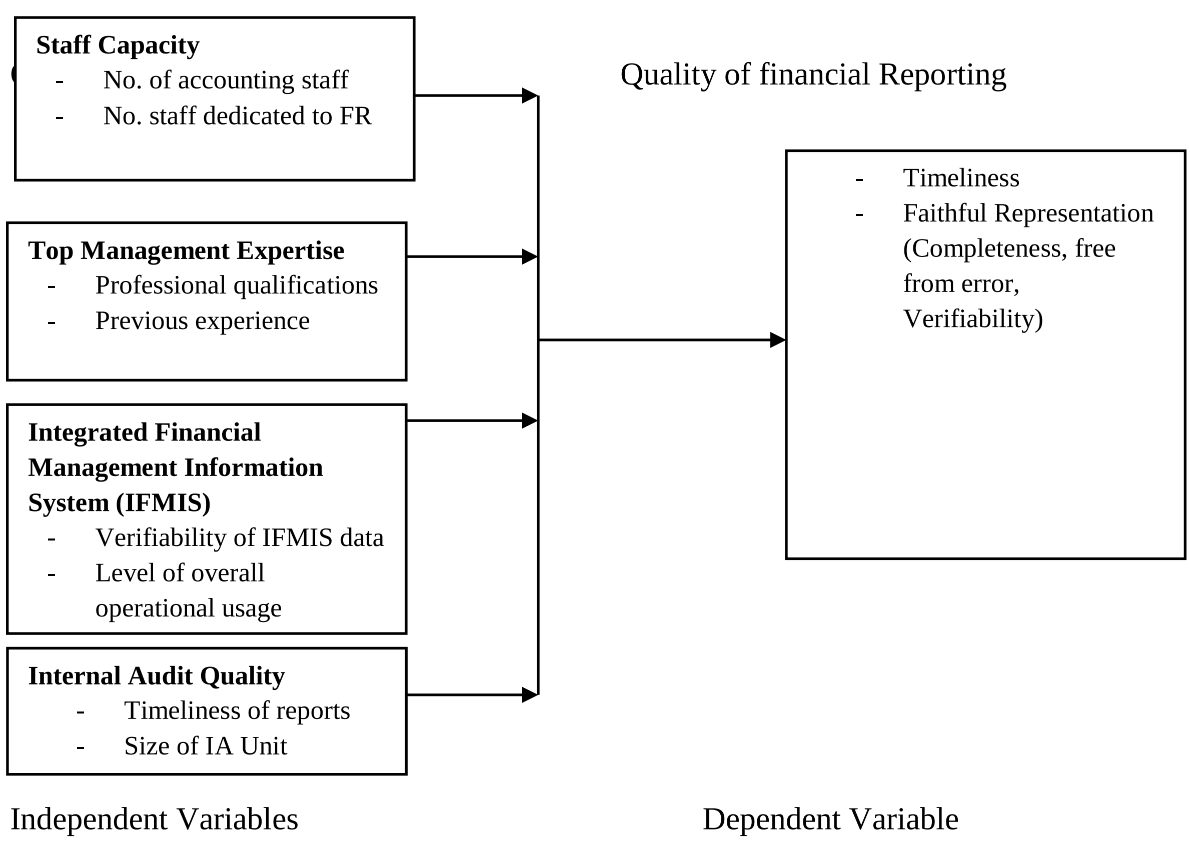

FIGURE 2.1

Conceptual Framework

2.7 Operational Definition of Variables

Operational definition is a description of a variable, term or object in terms of the specific process or set of validation tests used to determine its presence and quantity (Caswell, 1989). A variable is an empirical property that can take two or more values. Any property that can take change either in quantity or quality can be regarded as a variable (Chara, 1996).

Variables are classified in many different ways. The most common categories include the dependent and the independent variable. An independent variable is a variable that causes change in a dependent variable, a dependent variable on the other hand is a variable whose outcome depends on the manipulation of the independent variable (Creswell, 1994). Some variables were only operationalized by use of indicators, which are the observable evidence of the degree of presence or absence of the variable one is researching on.

Table 3.2 Operational definition of Variables

Objective	Type of Variable	Indicators	Scale of Measurement
To assess the effect of staff capacity on the quality of financial reporting.	**Independent** Staff capacity **Dependent** Quality of financial reporting	 - Number of accounting staff - Number of staff dedicated to financial reporting - Proper Allocation of duties - Timeliness - Faithful Representation	 - Ordinal - Ordinal - Nominal - Nominal - Nominal
To assess the relationship between top management expertise and the quality of financial reporting	**Independent** Top management expertise **Dependent** Quality of financial reporting	 - Professional qualifications - Financial reporting experience - Academic qualifications - Previous experience - Timeliness - Faithful Representation	 - Nominal - Nominal - Nominal - Nominal - Nominal - Nominal
To assess the effect of Integrated Financial Management on the quality of financial reporting	**Independent** IFMIS **Dependent** Quality of financial reporting	- Level of overall operational usage - Whether financial reporting is computerized - Reliability of accounting information from IFMIS system - Verifiability of IFMIS data - Timeliness - Faithful Representation	- Nominal - Nominal - Nominal - Nominal - Nominal - Nominal

To assess the effect of internal audit quality on the quality of financial reporting.	**Independent** Internal audit quality	- Timeliness of internal audit reports - Average experience level of internal audit staff - Size of internal audit unit(Number of staff)	- Nominal - Nominal - Nominal
	Dependent Quality of financial reporting	- Timeliness - Faithful Representation	- Nominal - Nominal

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter brings out the data collection research methodology in a bid to test the hypothesis of the study. It elaborates the sampling methods, sampling design and the sample size to be used. Source of information, research population and the target population was also identified.

3.2Research Design

Research design refers to the way the research will be designed i.e. the method to be used to carry out the research (Ngechu, 2004). This study adopted a descriptive research design. Descriptive research design allows a simultaneous description of views, perceptions and beliefs of the respondents at any given time. This study was also chosen because it enables the researcher to generalize the findings to a larger population. The findings of this research would therefore be generalized to other public sector entities to build stronger reporting framework to improve the quality of financial statements.

3.3Target Population

The target population is defined as all the members of a real or hypothetical set of people, events or objects to which a research wishes to generalize the results of the research study (Borg & Gall, 1989). Kombo and Tromp, 2006 state that a population involves a group of individuals, objects or items from which samples are taken for measurement. The target population for the study was therefore the 47 county governments in Kenya. The unit of analysis for this study was the county government.

3.4 Sampling and Sampling Procedures

Sampling is the act, process or technique of selecting a suitable sample, or a representative part of a population for the purpose of determining parameters or characteristics of the whole population.

A sample is a finite part of a statistical population whose properties are studied to gain information about the whole (Webster, 1985). When dealing with people, it can be defined as a set of respondents (people) selected for a larger population for the purpose of a survey. Any statement made about the sample should also be true of the population (Orodho, 2012). The research will adopt census sampling because the population is small. It is called census sample because data is gathered on every member of the population (University of Kentucky, 1865).

Category	**Target Population**	**Percentage Proportions**	**Census**
Accounting officers for Finance/Heads of Accounting	47	100%	47

3.5 Research Instruments

Tools for collection of data were questionnaires. The questionnaires were chosen because they can be easily administered, and can enable collection of data in a standardized way. A large sample of the population can also be contacted at a relatively low cost. Questionnaires give respondents freedom to express their views and also to make suggestions (Gay, 1992). The researcher adopted structured questionnaires which comprised of both close-ended and open ended questions.

3.6 Validity and Reliability of Research Instrument

Validity is the accuracy and meaningfulness of inferences, which are based on the research results (Mugenda &Mugenda, 1999). It is the degree to which results obtained from the analysis of the data actually represents the phenomenon under study. It is the degree to which a test measures what it purports to measure. (Borg & Gall, 1989). According to Borg & Gall (1989) content validity of an instrument is improved through expert judgment. The researcher will seek the assistance of the supervisor, an expert, in order to help in improving the content validity of the instrument (William O. Omamo, Hon. 1995).

Joppe (2000) defines reliability as the extent to which results are consistent over time. And an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable.

All qualitative characteristics were measured using two independent observers. This was necessary because judgment was required in assessing the quality of financial reporting based on the qualitative characteristics and lack of insider information may cause problems when interpreting and quantifying the qualitative characteristics (Botosan, 2004).

To test the inter-rater reliability, the inter-rater reliability coefficient krippendorff's alpha was calculated. This reliability statistic is rooted in content analysis and is applicable to various circumstances, including the use of ordinal and small sample sizes (krippendorff, 1980). If the krippendorff's alpha is above 0.7 then the results are reliable. Internal reliability was tested using the cronbach's alpha coefficient. Cronbach's alpha coefficient of 0.8 and above indicates that the instruments are reliable.

3.7 Data Collection Procedures

A research permit was obtained from the county governments through the office of the county secretary, after university approval. The county head quarter offices were contacted before the start of the exercise. The study collected primary data in form of questionnaires from the 47 chief finance officers in the county governments who were the targeted respondents in this study. Questionnaires with electronically checkable checkboxes were sent via email to all respondents. Respondents were given a period of three days to fill the questionnaires and send back via email. This was done to ease data collection and minimize use of resources.

3.8 Data Analysis

Data analysis is the observation of what has been gathered in a survey or experiment and making decisions and inferences (Kombo and Tromp, 2011). This study adopted a descriptive statistics to describe the quality of financial reporting as a phenomenon. The researcher describes the factors influencing the quality of financial reporting. The questionnaire adopted a Likert scale format of 1 to 5 with 1 indicating strong disagreement, 5 indicating strong agreement and 3 neither disagree nor agree. 1 in the Likert scale indicates the lowest degree while 5 indicates the highest degree. The study involved analysis of the relationship between the independent and dependent variables by ascertaining the significance level of each of the independent variables. The researcher gathered both quantitative and qualitative data. Quantitative data was analyzed using descriptive analysis and regression analysis while qualitative data was analyzed through content analysis. Mean scores were calculated for all the variable indicators to represent the score for the particular independent variable for purposes of regression. Analyzed data is presented in table formats accompanied by theoretical explanations of the results. Data clean up to ensure quality of the responses was done before data analysis.

3.8.1 Model Specification

The study adopted a Regression model as shown below

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where Y is the Dependent Variable; Quality of Financial Reporting

X_1 = Staff Capacity
X_2= Top management expertise
X_3= Integrated Financial Management Information System (IFMIS)
X_4= Internal Audit Quality
$\beta_0 - \beta_4$= Coefficients of the Variables being measured

ε= Error term

3.8.2 Diagnostic tests

Before performing regression analysis the data was tested for normality. Normality test involves checking whether data collected is normally distributed based on the assumptions of OLS. Among the tests is a test for multicollinearity. Correlation coefficients for the independent variables should be less than 0.8, otherwise a spurious relationship exists and one of the variables should be dropped. The data was tested for heteroskedasticity using the breusch-pagan test; this was done to determine the variance of the error term. To test for multicollinearity, VIF values were computed. A value between 1 and 10 indicates that there is no multicollinearity; otherwise a condition of multicollinearity is present and one of the independent variables shall be dropped.

3.9 Ethical Considerations

The researcher assured the respondents that utmost confidentiality in dealing with the responses will be adhered to. Aim and vitality of information given was understood by the respondents. Respondents were free to withdraw at their wish and assured of confidentiality and that information given was only utilized for the intended purpose, this was guaranteed by ensuring anonymity of where respondents were required to disclose their identity.

CHAPTER FOUR

FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter presents the findings and discussions of the study. It was guided by the objectives of the study to assess the effect of staff capacity on the quality of financial reporting, to assess the effect of top management expertise on the quality of financial reporting, to assess the effect of IFMIS on quality of financial reporting and to assess the effect of internal audit quality on financial reporting quality of county governments in Kenya.

4.1.1: Response Rate

This study targeted 47 county governments in Kenya. Thirty three of the targeted population responded which translates to 70%. This was found to be appropriate for decision making as recommended by Babbie (2002). Table 4.1 presents the response rate.

Table 4.1: Response Rate

Category	Population	Response Rate
Chief Finance Officers/Heads of Accounting	47	33
Total	**47**	**33**

The respondents were drawn from the 47 county governments in Kenya. The study focused on collecting data mainly from the Chief Officers for finance who are constitutionally mandated to be the Accounting officers for their county governments and the heads of accounting where the Chief Officer for finance could not be reached. This target population was therefore best placed to answer the questions relating to the quality of financial reporting of county governments in Kenya.

The respondents were asked to give their ratings on a Likert scale questionnaire formed on the basis of the study objectives. The respondents were required to fill background information on the first part of the questionnaire. The respondents were required to indicate their gender, number of years in which they have worked for the respective county governments and their level of concern in financial reporting of the county governments.

Approximately (90%) of the respondents were male, majority worked in the county for a period between 2-3 years and were very concerned with the quality of financial reporting of their respective county governments. This therefore gives reliability to the information provided.

4.1 The effect of staff capacity on the quality of financial reporting

Under this objective of the study, respondents were asked to indicate their level of agreement with various statements relating to staffing capacity. The respondents were requested to rate whether Capacity needs assessment has been carried out in their respective counties. Table 4.2 displays the results.

Table 4.2: Capacity needs assessment has been carried out

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	6	18.2	18.2	21.2
	3	5	15.2	15.2	36.4
	4	17	51.5	51.5	87.9
	5	4	12.1	12.1	100.0
	Total	33	100.0	100.0	

From the results 51.5% of the respondents agree that capacity needs have been carried out which is requisite for having competent personnel working in the county and hence quality financial reporting. 18.2% though disagreed with this statement with 15.2% being neutral.

Respondents were requested to rate the existence of an effective system of staff recruitment and selection in place to ensure only the best applicants for the job are selected. A majority of 48.5% agreed to this statement while 18.2% of the respondents were neutral when asked to rate this statement. 6.1% however strongly disagreed with this statement. Table 4.3 displays the results.

Table 4.3: Effective system of staff recruitment and selection

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	2	6.1	6.1	6.1
	2	1	3.0	3.0	9.1
	3	6	18.2	18.2	27.3
	4	16	48.5	48.5	75.8
	5	8	24.2	24.2	100.0
	Total	33	100.0	100.0	

The respondents were further requested to rate whether the department of finance and economic planning responsible for preparation of financial reports is adequately staffed. 63.6% agreed that the department is adequately staffed, while 12.1% disagreed with this statement. The majority response of 63.6% therefore indicates that the department is adequately staffed to perform its role of financial management and quality financial reporting. Table 4.4 displays the results.

Table 4.4 : Finance department is adequately staffed

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	4	12.1	12.1	15.2
	3	2	6.1	6.1	21.2
	4	21	63.6	63.6	84.8
	5	5	15.2	15.2	100.0
	Total	33	100.0	100.0	

The respondents were requested to rate whether the staffs working with the county governments have the requisite qualifications and experience to perform their roles including financial reporting. 54.5% of the respondents agreed to this statement while 27.3% strongly agreed. This therefore indicates that the staffs have qualifications and experience necessary for quality financial reporting. Table 4.5 shows the results

Table 4.5: Staff qualifications and level of experience

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	2	6.1	6.1	6.1
	2	2	6.1	6.1	12.1
	3	2	6.1	6.1	18.2
	4	18	54.5	54.5	72.7
	5	9	27.3	27.3	100.0
	Total	33	100.0	100.0	

Staffs working with the county governments receive adequate training from the National Treasury and the Institute of Certified Public Accountants of Kenya. The respondents were requested to rate this particular statement and 51.5% agreed to this statement while 9.1% strongly disagreed. A majority of 51.5% indicates that the National Treasury and ICPAK provided adequate training to build capacity for quality financial reporting. The strongly disagree of 9.1% could be attributed to Accountants who are not members of ICPAK and therefore do not receive invitations to various trainings conducted by ICPAK annually for its members in various sectors.

Table 4.6: Training by the National Treasury and ICPAK

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	3	9.1	9.1	9.1
	2	3	9.1	9.1	18.2
	3	4	12.1	12.1	30.3
	4	17	51.5	51.5	81.8
	5	6	18.2	18.2	100.0
	Total	33	100.0	100.0	

The respondents were asked to indicate the level in which they agree or disagree to a statement stating that, county government staffs understand the PFM Regulations relating to county government financial reporting. 42.4% of the respondents agreed to this statement, however, 27.3% were neutral. This indicates even though a majority of the respondents agree that PFM regulations are understood a significant number also do not agree or disagree to this statement. Table 4.7 shows the results.

Table 4.7: Understanding of PFM Regulations

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	4	12.1	12.1	12.1
	3	9	27.3	27.3	39.4
	4	14	42.4	42.4	81.8
	5	6	18.2	18.2	100.0
	Total	33	100.0	100.0	

A further question required the respondents to give their rating on a statement stating that the National Treasury and the IPSASB provide adequate support to the county governments in terms of financial reporting guidelines. From the results 45.5% of the respondents agreed to this statement, 24.2% strongly agreed while 21.2% were neutral when asked this question. This indicates that a vast majority were comfortable with the support the counties receive from the National Treasury and the IPSAB on financial reporting.

Table 4.8: IPSASB and National Treasury financial reporting guidelines

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	2	6.1	6.1	9.1
	3	7	21.2	21.2	30.3
	4	15	45.5	45.5	75.8
	5	8	24.2	24.2	100.0
	Total	33	100.0	100.0	

The respondents were asked to rate whether the top management supports and understands the importance of timely and quality financial reporting. 33.3% of the respondents agreed to this statement, 39.4% strongly agreed while 15.2% disagreed to this statement. The majority were comfortable with management support and understanding of the quality and timely financial reporting.

Table 4.9: Management support and understanding of financial reporting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	5	15.2	15.2	18.2
	3	3	9.1	9.1	27.3
	4	11	33.3	33.3	60.6
	5	13	39.4	39.4	100.0
	Total	33	100.0	100.0	

4.2 IFMIS and the quality of financial reporting

On trying to establish the effects of Integrated Financial Management Information System (IFMIS) on the quality of financial reporting, respondents were asked to rate a number of statements from the questionnaire as highlighted below.

The respondents were asked to indicate their level of agreement with a statement indicating that the county government supports the implementation and use of IFMIS system. 45.5% agreed with this statement while 51.5% strongly agreed. This is a good indication that respondents are comfortable with the support of top management on the use of IFMIS system.

Table 4.10: Management Support on the use of IFMIS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	4	15	45.5	45.5	48.5
	5	17	51.5	51.5	100.0
	Total	33	100.0	100.0	

The respondents were asked to indicate their level of agreement with a statement indicating that National Treasury, IFMIS department, provides adequate technical support to enable effective use of IFMIS system. 60.6% of the respondents agreed to this statement while 27.3% strongly agreed. This indicates that technical support from the National Treasury is adequate for quality financial reporting. Table 4.11 shows the results.

Table 4.11: National Treasury technical support

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	3	3	9.1	9.1	12.1
	4	20	60.6	60.6	72.7
	5	9	27.3	27.3	100.0
	Total	33	100.0	100.0	

The respondents were further asked to state their level of agreement in a statement indicating that all staffs using IFMIS system have been adequately trained to perform their roles in the system. 45.5% agreed to this statement while a significant percentage of 39.4% strongly agreed with this statement. Respondents are comfortable with the level of training even though they recommend training to be enhanced in order to improve financial reporting quality. Table 4.12 shows the results.

Table 4.12: Staff are adequately trained to perform their roles in IFMIS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	3	9.1	9.1	9.1
	3	2	6.1	6.1	15.2
	4	15	45.5	45.5	60.6
	5	13	39.4	39.4	100.0
	Total	33	100.0	100.0	

The study further sought to establish respondent's level of agreement on a statement indicating that IFMIS system produces financial reports that comply with the cash basis of accounting which is applicable in the county government financial reporting. 57.6% of the respondents agreed to this statement while 30.3% strongly agreed. This indicates that a vast majority are comfortable with the reports produced by the IFMIS system. Table 4.13 shows the results.

Table 4.13: IFMIS reports comply with cash basis of accounting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	1	3.0	3.0	3.0
	3	3	9.1	9.1	12.1
	4	19	57.6	57.6	69.7
	5	10	30.3	30.3	100.0
	Total	33	100.0	100.0	

The respondents were asked to state their level of agreement on a statement stating that the county governments produce financial statements entirely from the IFMIS system. 48.5% agreed to this statement while 33.3% strongly agreed. This is an indication that the respondents are comfortable with the level of IFMIS usage in the county government which is a requisite aspect of quality financial reporting. Table 4.14 shows the results.

Table 4.14: Financial reports are produced from the IFMIS system

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	2	6.1	6.1	6.1
	3	4	12.1	12.1	18.2
	4	16	48.5	48.5	66.7
	5	11	33.3	33.3	100.0
	Total	33	100.0	100.0	

The respondents were further asked to indicate their level of agreement in a statement stating that IFMIS supports timely and quality financial reporting in the county government. 54.5% of the respondents agreed to this statement while a significant 33.3% strongly agreed. This is an indication that IFMIS system is supporting timely and quality financial reporting. Table 4.15 shows the results.

Table 4.15: IFMIS supports timely and quality financial reporting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	1	3.0	3.0	6.1
	3	2	6.1	6.1	12.1
	4	18	54.5	54.5	66.7
	5	11	33.3	33.3	100.0
	Total	33	100.0	100.0	

The respondents were further asked to indicate their level of agreement in a statement indicating that IFMIS is responsible for poor public sector financial reporting. 15.2% of the respondents disagreed with this statement, 21.2% were neutral, 30.3% agreed while 24.2% strongly agreed. This is an indication that IFMIS system is partly contributed to poor financial reporting quality of the public sector in Kenya. Table 4.16 shows the results.

Table 4.16: IFMIS is responsible for poor public sector financial reporting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	3	9.1	9.1	9.1
	2	5	15.2	15.2	24.2
	3	7	21.2	21.2	45.5
	4	10	30.3	30.3	75.8
	5	8	24.2	24.2	100.0
	Total	33	100.0	100.0	

4.3 Effect of internal audit quality on the quality of financial reporting

To establish the effect of internal audit quality on the quality of financial reporting eight statements were put up for rating by the respondents on the questionnaire as highlighted below. The respondents were asked to indicate their level of agreement with a statement stating that the county government has an efficient and effective internal audit function in place. 24.2% of the respondents disagreed with this statement while 54.5% agreed, a significant 18.2% were neutral to this statement. This is an indication that there is a mixed perception on the effectiveness and efficiency of the internal audit function. This therefore casts doubts on the quality of internal audit function in the county governments. Table 4.17 shows the results.

Table 4.17: Efficient and effective internal audit function is in place

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	1	3.0	3.0	3.0
	2	8	24.2	24.2	27.3
	3	6	18.2	18.2	45.5
	4	18	54.5	54.5	100.0
	Total	33	100.0	100.0	

The respondents were asked to indicate their level of agreement on a statement indicating that the internal audit staffs are professionally and academically qualified to perform internal audit. 54.5% of the respondents agreed to this statement, 21.2% are neutral. 15.2% of the respondents however disagreed to this statement. A vast majority of 54.5% agreeing to this statement therefore indicates that counties have employed qualified professionals in the internal audit departments.

Table 4.18: Audit staff are professionally and academically qualified

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	2	6.1	6.1	6.1
	2	5	15.2	15.2	21.2
	3	7	21.2	21.2	42.4
	4	18	54.5	54.5	97.0
	5	1	3.0	3.0	100.0
	Total	33	100.0	100.0	

The respondents were asked to indicate their level of agreement on a statement which stated that the internal audit function is concerned about the quality of financial reporting in the county government.12.1% strongly disagreed with this statement, 15.2% disagreed, and 24.2% were neutral while 36.4%. Table 4.19 shows the results. This is an indication that internal audit department is less concerned with the quality of financial reporting of their county governments.

Table 4.19: Internal audit is concerned about the quality of financial reporting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	4	12.1	12.1	12.1
	2	5	15.2	15.2	27.3
	3	8	24.2	24.2	51.5
	4	12	36.4	36.4	87.9
	5	4	12.1	12.1	100.0
	Total	33	100.0	100.0	

The respondents were asked to indicate their level of agreement to a statement indicating that the county government has an efficient and effective audit committee in place. 12.1% of the respondents strongly disagreed with this statement, 21.2% disagreed while 36.4% of the respondents were neutral. Only 24.2% of the respondents agreed to this statement. This indicates that audit committee has not been felt or is completely not in place. Table 4.20 shows the study results.

Table 4.20: Efficient and effective audit committee is in place

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	4	12.1	12.1	12.1
	2	7	21.2	21.2	33.3
	3	12	36.4	36.4	69.7
	4	8	24.2	24.2	93.9
	5	2	6.1	6.1	100.0
	Total	33	100.0	100.0	

The respondents were further asked to indicate their level of agreement to a statement indicating that management picks audit recommendations and institutes them in order to improve financial controls and hence quality of financial reporting. 36.4% of the respondents agreed to this statement while 30.3% were neutral. This indicates that a vast majority were comfortable with handling of audit recommendations in the county, though 15.2% of the respondents strongly disagreed. Table 4.21 shows the results.

Table 4.21: Audit recommendations are instituted by management in order to improve financial reporting

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	5	15.2	15.2	15.2
	2	3	9.1	9.1	24.2
	3	10	30.3	30.3	54.5
	4	12	36.4	36.4	90.9
	5	3	9.1	9.1	100.0
	Total	33	100.0	100.0	

The respondents were further asked to state their level of agreement to a statement indicating that management and accounting staff understand the meaning of the different types of audit opinions and are committed to better financial reporting practices. 12.1% of the respondents disagreed to this statement, 12.1% were neutral while 57.6% agreed. This mixed reaction indicates that there is a need for staff and management sensitization on audit opinion meaning and interpretation. Table 4.22 shows the results

Table 4.22: Management and accounting staff understand the meaning of different types of audit opinions and are committed to better financial reporting practices

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	3	9.1	9.1	9.1
	2	4	12.1	12.1	21.2
	3	4	12.1	12.1	33.3
	4	19	57.6	57.6	90.9
	5	3	9.1	9.1	100.0
	Total	33	100.0	100.0	

The respondents were further asked to indicate their level of agreement to a statement indicating that bank reconciliations are performed on regular basis. 39.4% agreed to this statement while 21.2% were neutral. This indicates that bank reconciliations, key practice to better financial reporting are performed regularly. Table 4.23 indicates the results.

Table 4.23: Bank reconciliations are performed regularly

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	2	6.1	6.1	6.1
	2	5	15.2	15.2	21.2
	3	7	21.2	21.2	42.4
	4	13	39.4	39.4	81.8
	5	6	18.2	18.2	100.0
	Total	33	100.0	100.0	

The respondents were finally asked to state their level of agreement to a statement indicating that the county government maintains an up to date asset register and ensures a safe custody for all assets. 9.1% of the respondents strongly disagreed to this statement while the same percentage disagreed. 12.1% were neutral while a significant 57.6% agreed to this statement. This mixed reaction indicates that an improvement is necessary to raise the level of agreement in this statement in future. Table 4.24 shows the results.

Table 4.24: An up to date asset register exists and assets are in safe custody

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	3	9.1	9.1	9.1
	2	3	9.1	9.1	18.2
	3	4	12.1	12.1	30.3
	4	19	57.6	57.6	87.9
	5	4	12.1	12.1	100.0
	Total	33	100.0	100.0	

4.4 Top management expertise and the quality of financial reporting

This study also sought to establish the effect of top management expertise on the quality of financial reporting. Respondents were asked to state their level of agreement to a statement indicating that professional background of the top management influences the quality of financial reporting. 42.4% of the respondents agreed to this statement while a similar percentage strongly agreed. This result indicates that county governments should hire managers with accounting and financial reporting background in order to improve the quality of financial reporting. Table 4.25 indicates the results.

Table 4.25 Professional background of the top management

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	3	5	15.2	15.2	15.2
	4	14	42.4	42.4	57.6
	5	14	42.4	42.4	100.0
	Total	33	100.0	100.0	

Respondents were further asked to rate a statement indicating that top management previous experience influences the quality of financial reporting; 33.3% of the respondents agreed to this statement while a further 45.5% of the respondents strongly agreed to this statement. Previous experience of the top managers is therefore key to their performance in financial reporting. Counties should hire managers with past experiences relevant to the field of accounting. Table 4.26 shows the results.

Table 4.26 Previous experience of the top management

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	1	3.0	3.0	3.0
	3	6	18.2	18.2	21.2
	4	11	33.3	33.3	54.5
	5	15	45.5	45.5	100.0
	Total	33	100.0	100.0	

A third statement required the respondents to rate whether top management consistently builds its financial reporting skills through seminars and conferences. 51.5% agreed while 27.3% strongly agreed to this statement. This is an indication that with time the quality of financial reporting will improve if the top managers will continue to improve their skills on financial reporting quality. Table 4.27 shows the results

Table 4.27 Top management consistently builds its financial skills through seminars and conferences

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	5	15.2	15.2	15.2
	3	2	6.1	6.1	21.2
	4	17	51.5	51.5	72.7
	5	9	27.3	27.3	100.0
	Total	33	100.0	100.0	

The respondents were further asked to rate a statement indicating that top management makes available financial reporting guidelines for use by all preparers of financial statements which in turn influence the quality of financial reporting. 57.6% of the respondents agreed to this statement, 24.2% strongly agreed. A significant 12.1% of the respondents however were neutral to this statement. This is an indication that top management avails the necessary financial reporting guidelines for the county governments. Table 4.28 shows the results

Table 4.28 Top management makes available financial reporting guidelines

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	2	6.1	6.1	6.1
	3	4	12.1	12.1	18.2
	4	19	57.6	57.6	75.8
	5	8	24.2	24.2	100.0
	Total	33	100.0	100.0	

The respondents were asked to rate a statement asking whether the top management have relevant qualifications to perform their roles as accounting officers. 57.6% of the respondents agreed to this statement while a further 24.2% strongly agreed. This is an indication that the respondents across the counties in Kenya are comfortable with the current qualifications of the top management. Table 4.29 shows the results

Table 4.29 Top management have relevant qualifications to perform their roles

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2	2	6.1	6.1	6.1
	3	4	12.1	12.1	18.2
	4	19	57.6	57.6	75.8
	5	8	24.2	24.2	100.0
	Total	33	100.0	100.0	

4.5 Regression Analysis

Regression analysis was performed to test the model that quality of financial reporting is affected by staff capacity, IFMIS system, internal audit quality and top management expertise. The regression model used was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where Y is the quality of financial reporting

X_1 = Staff Capacity

X_2 = IFMIS System

X_3= Internal audit quality

X_4= Top management expertise

β_0= Constant

β_1- β_4= Coefficients of the variables being measured

ε= Error term

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

$$Y = 0 + 0.618 + 0.278 + 0.377 + 0.055 + 1.02$$

The results of the regression analysis are presented below.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.853[a]	.728	.689	.546	1.148

a. Predictors: (Constant), top management expertise

, Staff Capacity, IFMIS system, Internal audit quality

b. Dependent Variable: Financial Reporting Quality

From the model summary, the multiple correlation coefficients (R) is a determinant of the association between the quality of financial reporting (Y) and the four independent variables (X_1, X_2, X_3 and X_4). From the regression summary, R = 0.853 which implies that a moderate to strong association exists. By squaring R we recognize the value of the coefficients of multiple determinations (R^2). This statistic makes it possible to determine the total of explained variance in Y from the four independent variables on a percentage range of 0 – 100. This therefore means that 72.8% of the change in the dependent variable (Y) is explained by the collective change in the independent variables (X_1, X_2, X_3 and X_4)

The F-ratio in ANOVA is used to establish if or not R^2may possibly have arisen out of chance. The F-ratio computed in the ANOVA table computes the possibility of chance straying from a straight line. Analysis of variance (ANOVA) results are displayed in the table below.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	22.365	4	5.591	18.722	.000[b]
	Residual	8.362	28	.299		
	Total	30.727	32			

a. Dependent Variable: Quality of financial reporting

b. Predictors: (Constant), Top management expertise, Staff Capacity, IFMIS System, Internal audit quality

From the ANOVA results table, the overall equation was statistically significant (F=18.722, p<.000).

Coefficients summary table given below establishes which independent variables are highly contributing to the 72.8% of the change in Y ($R^2 = 0.728$) and which ones are not, and how the vital ones help us to give explanations of Y. For every independent variable in the equation the researcher was interested in its standardized beta and t-test statistic's level of significance (Sig.) With a p<0.05, the predictor was said to be statistically significant. When p-value (Sig.) is under or equivalent to 0.05, the matching beta is statistically significant in the model.

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.	Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)	-2.660	1.021		-2.606	.015		
	V2	.647	.117	.618	5.536	.000	.780	1.282
	V3	.344	.153	.278	2.248	.033	.634	1.576
	V4	.333	.114	.377	2.914	.007	.580	1.725
	V5	.138	.281	.055	.490	.628	.769	1.300

a. Dependent Variable: Quality of financial reporting

From the coefficients table all the four independent variables are significant in predicting the value of Y. However, staff capacity ($\beta = 0.618, p < .000$) has a highly significant influence to the quality of financial reporting. It was therefore established that, though internal audit quality, IFMIS system and top management expertise had a role to play in the attainment of quality financial reporting, Staffing capacity was seen to have a higher consequence on the quality of financial reporting of the county governments in Kenya.

The findings of this study concur with existing literature on factors influencing the quality of financial reporting. According to Canadian Social Science, 2013, capacity development is an indispensable component of human resource if organizational goals are to be achieved. This study links the quality of financial reporting to staff capacity and hence their their development.

According to Tarus et al., 2015, use of computerized technology, staff professional exposure and internal training contribute to quality of financial reporting in Kenya's banking sector. This study found staff capacity as well as IFMIS system to have a positive impact on the quality of financial reporting. This study also concurs with the first archival study to link Internal

Audit Quality (IAQ) to Financial Reporting Quality (FRQ); this study was pioneered by Prawitt, Smith and Wood in 2009. The current study finds a positive relationship between internal audit quality and the quality of financial reporting.

This study found the top management expertise to influence the quality of financial reporting. It therefore concurs with the upper echelons theory in management literature. This theory finds that corporate actions and strategic choices are partially predicted by the functional background of executives (Hambrick and Mason 1984, Thomas et al., 1991, Hambrick, 2007).

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter covers the study summary, conclusions and recommendations. These were drawn from the findings of the study presented in chapter four and from research objectives set out in chapter one of this study.

5.2 Summary of the study

The study sought to determine the factors influencing the quality of financial reporting of county governments in Kenya. This study was achieved by seeking answers to four questions which included. How does Staffing capacity influence the quality of financial reporting? How does IFMIS system influence the quality of financial reporting? How does internal audit quality influence the quality of financial reporting? How does top management expertise influence the quality of financial reporting? They addressed study specific objectives that included: to assess the effect of staffing capacity on the quality of financial reporting; to assess the effect of IFMIS on the quality of financial reporting; to assess the effect of internal audit quality on the quality of financial reporting and to assess the effect of top management expertise on the quality of financial reporting.

The study used descriptive survey research design. The population target was the Chief Officers for Finance working in the county governments in Kenya. The researcher carried out census survey of all 47 targeted respondents. This is because the target population was small in number and was also easily accessible. Data was analyzed using both quantitative and qualitative methods through simple descriptive analysis and content analysis respectively.

This study revealed that capacity needs assessment has been done in most of the counties in Kenya. This is an indication that the counties have the right staff for the right job. From the study the county governments have an effective and efficient system of staff recruitment and selection and that the staffs have requisite qualifications and experience to perform financial role. The study also established that there is adequate training of staff by the National Treasury and ICPAK and that PFM regulations are understood by those responsible for managing county financial resources. The study also established that the top management of the county governments supports timely and quality financial reporting. According to the respondents staff capacity highly influences the quality of financial reporting.

Towards IFMIS system, it was established that the top management of the county governments and the National Treasury (Department of IFMIS) provided adequate support for implementation and use of IFMIS system. 34% of the respondents disagreed that all staff using IFMIS system have been adequately trained. This is an indication an improvement in terms of IFMIS training is necessary to boost the efficiency of the system. It was established that the county governments produce reports from the IFMIS system and that they too comply with the cash basis of accounting.

The study revealed that the internal audit function in the county governments was not effective in instituting internal controls. Most of the counties did not have audit committee in place; however, internal audit staffs have requisite experience to perform the job. It was established that the internal audit was not concerned about the quality of financial reporting in the county governments. The study also established that management picked and instituted audit recommendations for better financial reporting. Bank reconciliations were performed regularly by the county governments in Kenya indicating a sign of compliance to PFM regulations and hence promoting quality of financial reporting.

According to the study, previous experience of the top management and background in financial reporting in financial reporting influenced the quality of financial reporting of county governments in Kenya. The study revealed that top managements have relevant academic qualifications and built their financial reporting skills through seminars and conferences. According to the respondents, top management expertise has a direct influence on the quality of financial reporting.

The regression analysis revealed that even though IFMIS system, internal audit quality and top management expertise influence the quality of financial reporting, staff capacity ($\beta = 0.618, p < .000$) has a highly significant consequence on it. This could be attributed to the fact that the effectiveness of IFMIS system, depends too on the staffing capacity, their skills and competence.

5.3 Conclusion

This study concluded that building staff capacity to enhance their competency is of paramount importance in attaining quality financial reporting in the county governments. Training on PFM Regulations, IFMIS systems and government financial operations are necessary in order to develop staff capacity. Counties have efficient and effective system of staff recruitment and selection and therefore the right staff for the right job.

The study concluded that IFMIS is a reliable system of accounting as it supports timely and quality financial reporting. The system reports also comply with the cash basis of accounting which is currently the recommended standards in the Kenya’s Public Sector. Even though the existing literature has underscored the quality of financial reporting in Kenya's public sector, IFMIS system is not responsible according to this study.

The internal audit function ought to be more effective in instituting internal control and on performing internal audit. This will help to strengthen the system and provide a good foundation for the external audit. Audit committee needs to be set up as it complements the roles of the internal audit department. The study however concluded that internal audit function is not highly significant in determining the quality of financial reporting.

From the regression analysis, the study concludes that staff capacity is highly significant in determining the quality of financial reporting. ICPAK, the National Treasury, Internal Public Sector Accounting Standards Board (IPSAB) are providing adequate support in developing capacities for purposes of quality financial reporting in the Public Sector.

5.4 Recommendations

The study recommends that the county governments should focus more on building staff capacities in order to improve the quality of financial reporting. Suggested ways to improve the quality of financial reporting should be adapted by the county governments. Regular trainings on use of IFMIS system should be conducted to enhance its reliability. The National Treasury, ICPAK and the IPSAB should provide relevant guidelines on the applicable financial reporting standards in order to enhance the quality of financial reporting in the Public Sector. In addition to this, employees in the public sector should be abreast with the current financial reporting standards to enhance the quality of financial reporting of their county governments.

5.4.1 Future studies

Further studies should focus on the applicability of IPSAS Cash basis in Kenya's public sector. Studies should focus on the plight of Public Sector assets in the current reporting framework. Physical assets form the greatest bulk of public resources and investments and their reporting as a disclosure in the financial statements is underscoring their value and importance. The scholars should also focus on Kenya's public sector preparedness for the accrual basis of accounting, as is planned to take off in a year's time.

5.4.1 Limitations of the study

This study has encountered several limitations. This study targeted all the 47 county governments in Kenya, however only 33 county governments responded. Limited resources in terms of time and money hindered 100% coverage of the targeted population. This would have been more extensive and exhaustive research for future use by the government of Kenya, ICPAK and other scholars. This nevertheless did not entirely inhibit the researcher from pursuing the study objectives and drawing conclusions. The highlighted beneficiaries will still be able to draw benefits from this study.

Some of the respondents were either too busy to fill the questionnaires or are attending official duties outside the office and were therefore not available. To reach 100% response rate for this research would have called for much time which the researcher did not have. The study therefore assumed that responses received make a reliable representation of the targeted population; the researcher was therefore able to draw conclusions of the study from the data provided.

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APPENDIX 1: TRANSMITTAL LETTER

Josphat Lodi Lekamario

KCA University

School of Business and Public Management

P.O. Box 56808-00200

NAIROBI.

April, 2017

Dear Respondent

<u>RE: QUESTIONNAIRE</u>

I am a student at KCA University School of business and public management undertaking a Master's degree (Master of Science in Commerce, Finance and Accounting Option). The University requires me to carry out a research based on finance or accounting area as a partial fulfillment for the award of Master of Science in Commerce.

I am carrying out a research to determine the factors influencing the quality of financial reportingof county governments in Kenya. I therefore write to request you to fill the attached questionnaire within three days so as to enable me accomplish the study.

At the end of the study I promise to share the results of this research, which will supplement the existing knowledge on studies relating to quality of financial reporting.

Please note that the information shall be purely for academic purposes and shall be treated as confidential as is practically possible.

Thank you for taking your time to fill the questionnaire.

JOSPHAT LODI LEKAMARIO

STUDENT, KCA UNIVERSITY

APPENDIX II: QUESTIONNAIRE

PROJECT TITLE: FACTORS INFLUENCING THE QUALITY OF FINANCIAL REPORTING OF COUNTY GOVERNMENTS IN KENYA

PART 1: General Information

1. Your County…………………………………………………..

2. Age

   Between 30-35years ☐

   Between 36-40years ☐

   Between 41-45years ☐

   Above 45 years ☐

3. Gender: Male ☐

   Female ☐

4. For how long have you worked with the County Government?

   Less than 1year ☐

   Between 1-2years ☐

   Between 2-3years ☐

   More than 3years ☐

5. What is your concern on the quality of County government financial reporting?

   Very Concerned ☐

   Concerned ☐

   Neutral ☐

   Not concerned ☐

PART 2

INSTRUCTIONS: Please indicate your level of agreement or disagreement with each of the following statements by placing a checkmark in the appropriate checkboxes.

Key: 1. Strongly Disagree 2.Disagree 3.Neutral 4. Agree 5.Strongly Agree

PART A: Staffing Capacity and the quality of financial reporting

		1	2	3	4	5
1.	Capacity needs assessment has been carried out in my county	☐	☐	☐	☐	☐
2.	The county government has an effective system of staff recruitment and selection in place to ensure only the best applicants are selected for the job	☐	☐	☐	☐	☐
3.	The department of finance and economic planning responsible for financial management and reporting is adequately staffed	☐	☐	☐	☐	☐
4.	The accounting staffs working with the county government have the requisite qualifications and experience to perform their roles including financial reporting	☐	☐	☐	☐	☐
5.	The accounting staffs working with the county government receive adequate training from both the National Treasury and the Institute of Certified Public Accountants of Kenya	☐	☐	☐	☐	☐
6.	The accounting staffs understand the PFM Regulations relating to county government financial reporting	☐	☐	☐	☐	☐
7.	The County Government receives adequate support from the National Treasury and the International Public Sector Accounting Standards Board (IPSASB) in terms of financial reporting guidelines	☐	☐	☐	☐	☐
8.	The top management in the county government supports and understands the importance of timely and quality financial reporting	☐	☐	☐	☐	☐

9. In your own view, what could be done to improve the quality of financial reporting of your county?

…………………………………………………………………………………………

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PART B: Top management expertise and the quality of financial reporting

		1	2	3	4	5
1.	Professional background of the top management influences the quality of financial reporting	☐	☐	☐	☐	☐
2.	Top management previous experience influences the quality of financial reporting	☐	☐	☐	☐	☐
3.	Top management consistently builds its financial reporting skills through seminars and conferences	☐	☐	☐	☐	☐
4.	The top management makes available financial reporting guidelines for use by all preparers of financial statements which in turn influences the quality of financial reporting	☐	☐	☐	☐	☐
5.	The top management have relevant academic qualifications that suit their roles as accounting officers	☐	☐	☐	☐	☐

In your own view, does the top management endeavor to improve the quality of financial reporting? What recommendations do you make for the top management in order to improve the quality of financial reporting?

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PART C: IFMIS and the quality of financial reporting.

		1	2	3	4	5
1.	The top management of the county supports the implementation and use of IFMIS system	☐	☐	☐	☐	☐
2.	The National Treasury, IFMIS department, provides adequate technical support to enable effective use of IFMIS system	☐	☐	☐	☐	☐
3.	All staffs using IFMIS system have been adequately trained to perform their roles in the system	☐	☐	☐	☐	☐
4.	The IFMIS system produces financial reports that comply with the cash basis of accounting which is applicable in the county government financial reporting	☐	☐	☐	☐	☐
5.	The county government produces financial statements entirely from the IFMIS system	☐	☐	☐	☐	☐
6.	IFMIS supports timely and quality financial reporting of the county government	☐	☐	☐	☐	☐
7.	IFMIS is responsible for poor public sector financial reporting	☐	☐	☐	☐	☐

9. In your own view does IFMIS system support quality financial reporting in the county government? What do you think could be done to make IFMIS more effective as a financial management and reporting system in the county government?

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PART D: Internal audit function and the Quality of Financial Reporting

		1	2	3	4	5
1.	The county government has an efficient and effective internal audit department in place	☐	☐	☐	☐	☐
2.	The internal audit function staff are professionally and academically qualified to perform internal audit	☐	☐	☐	☐	☐
3.	The internal audit function is concerned about the quality of financial reporting of the county government	☐	☐	☐	☐	☐
4.	The county government has an efficient and effective audit committee in place	☐	☐	☐	☐	☐
5.	Audit recommendations are picked by management and instituted in order to improve financial controls and quality of financial reporting	☐	☐	☐	☐	☐
6.	Management and the accounting staff understand the meaning of the different types of audit opinions and are committed to better financial reporting practices	☐	☐	☐	☐	☐
7.	Bank reconciliations are performed on regular basis	☐	☐	☐	☐	☐
8.	The county government maintains an up to date asset register and ensures a safe custody for all county government assets	☐	☐	☐	☐	☐

9. In your own view what controls should be instituted by the internal audit function to ensure efficient utilization of public resources and address financial reporting challenges of your county?

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PART E: Financial Reporting quality of the county government

Please rate the following attributes that measure the quality of financial reporting.

		1	2	3	4	5
1.	The financial reports have relevant disclosures as prescribed by the cash based International Public Sector Accounting Standards e.g. Asset register, Pending bills e.tc	☐	☐	☐	☐	☐
2.	The financial statements comply with the International Public Sector Accounting Standards; Cash basis	☐	☐	☐	☐	☐
3.	The financial reports are free from errors	☐	☐	☐	☐	☐
4.	The financial reports are prepared within the timely framework as required by PFM Act, 2012.	☐	☐	☐	☐	☐
5.	The financial reports are comparable to other county government entities in Kenya	☐	☐	☐	☐	☐
6.	Financial reports are verifiable	☐	☐	☐	☐	☐
7.	Financial reports are complete	☐	☐	☐	☐	☐

Please comment on the quality of financial reporting for the county governments in Kenya.

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END OF QUESTIONNAIRE

Thank you for participating in this exercise.