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Public Financial Reporting Practices, Regulations and Accountability for State-Owned Enterprises in Kenya

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Abstract: ***This paper assesses the financial reporting and regulation practices in state owned corporations in Kenya. The paper reviews available literature on financial reporting and regulation practices in state owned corporations in Kenya. State owned corporations are instrumental in the delivery of health, education, transport, and other critical services as they continue to account for a significant portion of economic society. This study is motivated by the challenges facing state owned corporations in Kenya as per the reports of Auditor general on weaknesses of financial reporting practices in state owned corporations in Kenya (2021/2022).The report shows that there is poor accountability in most of state owned corporations for the use of resources provided by the government which result into fraud, waste, corruption, misappropriation of funds, and limits their ability to deliver adequate public services and maintain their good standing. The report further shows that, most of state-owned organizations are also faced with challenge of poor financial reporting practices as reflected in misuse of financial resources, resulting in constant loss making. The focus of this research will be to examine the relationship between public financial reporting practices and accountability of state-owned corporations in Kenya. The study shall be guided by the following objectives: To establish the relationship between budgeting practices, financial statements, staff competencies, IFMIS and regulation practices on accountability of state owned corporations in Kenya. The study shall adopt budget participatory theory, theory of inspired confidence and Agency theory. Exploratory research design shall be adopted. The target population of study is comprised of 187 state owned corporations in Kenya. A sample of 127 firms will be selected using a stratified random sampling technique. The respondents will be senior officers in finance/governance, compliance, IT and HR, who are considered in the study sample. Semi structured questionnaires will be designed to collect research data with drop and pic method shall be adopted. The collected data shall be analyzed using a mixture of quantitative and qualitative research approach. Results and findings shall be presented in tables and figures. The study recommends that the finance managers of state-owned corporations should closely work with budgeting committee to ensure effective budget compliance and full implementation for improved accountability of the corporations. The accountants of state-owned corporations should ensure that regular financial statements are prepared in line with International Financial Reporting Standards. Further, it is recommended that IFMIS connectivity should be improved, and that staff capacity building should be carried out. The policy makers of all state-owned corporations should regularly review and advise the management on regulations that are likely to affect accountability in their entities. The chief Executive Officer of State-owned corporations should initiate policy guidelines regarding corporate financial governance and ensure that there is full implementation with regular feedback. The paper also recommends the need to strengthen the sanction enforcement mechanism for those found involved in financial malpractices.***

Keywords: Accountability, Public Financial Reporting, Regulations, State Owned Corporations

1. Background of the Study

State-owned corporations are established with an aim of improving social wellbeing of general citizens and provide goods and services that are economically unavailable or are too expensive to be offered by private sector (Ginting & Naqvi, 2020). Emerging markets and most frontiers use state-owned corporations to enhance industrialization while developed countries such as USA, UK, China and Japan use them as channels to promote public interests and performance of their economic growth (Li et al., 2020). Since state owned corporations control key sectors of the economy, they are allocated a lot of public funds that need to be managed accurately and transparently in order to benefit the greater public population. Financial reporting and regulations practices are identified as critical pillars that enhances transparency and accountability in state owned corporations. These two components are also the main elements that ensures adequate public financial management and service delivery in state owned corporations (Scott, 2018). Financial reporting includes statements of financial position, statement of comprehensive income statement, cash flow statements, stakeholder's statements of equity with formal records of a person, business, or entity's monetary activities and position. Most states in Latin America adopted International public sector accounting standards in financial reporting to improve transparency and accountability in its government institutions (Montesinos, et al., 2016). The government of United Kingdom adopted financial reporting reforms to improve delivery of services in its local government (Ferry & Eckersley, 2015). One of the greatest challenges towards realizing accountability in public entities is lack of adequate financial reporting and regulations framework. Article 201 of the constitution of Kenya highlights good governance, transparency, integrity and accountability as key principles and values for public finance that should be embraced by anyone holding public office (Mwenda, 2010). Accountability is becoming a critical issue in Kenya's public domain especially with state owned corporations. Accountability enhances the integrity of those who hold public offices and ensures that public resources are put into adequate use. Corruption reports in state owned corporations have raised several questions on leadership and employee's fidelity to accountability in state owned corporations. Financial reports from the office of Auditor General indicates that, there is improper financial control systems that have resulted to misuse of public funds by state owned corporations. Case in point, is the "KEMSA COVID-19 Billionaires" where approximately KES. 7.8 billion Bypassed IFMIS procurement system and paid for supply of overpriced goods without supporting documents (Audit general report, 2020). This study provides an insight into the nature of financial reporting and regulation practices in state-owned corporations in Kenya.

Statement of the Problem

State owned corporations are entities established under the parliamentary Act, to provide quality goods and services that are economically unavailable or are too expensive to be offered by private sector of a particular country (Ginting & Naqvi, 2020). State owned organizations face several financial and service performances related challenges. Many governments and international organizations have tried several ways to improve financial, operational, and fiscal performance of SOEs without adequate success. For instance, Gambia Integrated State-owned Enterprises Framework report, revealed that SOEs face a wide range of challenges that include insolvency, weak accounting systems, overstatement of assets, weak financial reporting systems and corporate governance issues (World Bank, 2021). Reports from the World Bank indicate that, a third of the 46 commercial state-owned corporations in Kenya made losses in the last three consecutive years between 2018-2020 financial years (World Bank, 2021). For example, a number of state-owned organizations such as, National oil corporation of Kenya, postal corporation of Kenya, Nzoia sugar were declared insolvent by the auditor General in the financial year ended 30th June 2021, while Kenya power and lighting company and Kenya railways corporations were noted as unprofitable. Kenya broadcasting corporation and East Africa Portland Cement were mentioned in the same report as loss making (Government of Kenya, 2021). The Auditor General reports extensively detail the nature of financial reporting in state-owned corporations in Kenya. According to Auditor General's report released in 2022, weaknesses in financial reporting and failure to account properly for spent funds by state owned organizations, has led to increased cases of fraud, waste, misappropriation, and rampant misuse of public resources (Government of Kenya, 2022). Several studies have been conducted on financial reporting and performance, such as Setyawan.W, & Gamayuni, R.R (2020) who assessed the quality of financial reporting and internal control system in Indonesia local Government. The study revealed that adoption of IPSAS in e-budgeting, enhanced credibility, integrity, and reliability of financial reporting in the public sector of Indonesia. Manyange et al (2020) established a significant association between financial reporting on control activities and financial accountability in South Nyanza County government while Ouma V. (2017) determined the relationship between reporting quality and financial performance of companies listed at Nairobi security exchange. Few research studies have been undertaken to establish the relationship between public financial reporting practices and accountability of state-owned corporation in Kenya. Most of the studies that have been done concentrated on the developed economies. This study seeks to fill this gap by assessing the relationship between public financial reporting practices, regulations, and accountability of state-owned corporations in Kenya.

General Objective of the Study

The general objective of the study will be to establish the relationship between public financial reporting practices and regulations on accountability of state-owned corporations in Kenya.

Specific Objectives of the Study

1) To establish the relationship between budgeting practices and accountability of state-owned corporations in Kenya
2) To examine the relationship between regulation practices and accountability of state-owned corporation in Kenya.

Research Questions:

1) Does budget reporting practices have relationship with accountability in state owned organizations in Kenya?
2) Does regulation practices have relationship with accountability in state owned organizations in Kenya?

2. Theoretical Review

2.1 Theory of Participative Budgeting

Participatory budgeting is one of the most successful instruments of participation and has been used for the last two decades. Participatory budget originated in 1990 in 12 Brazilian cities and extended very fast to more than 300 municipalities worldwide by the year 2005 and was introduced in Kenya during promulgation of the new constitution in 2010 (Shah, 2007). It is the responsibility of the government to call for public hearings where members of the public can suggest their priorities needs that inform the budget for a particular year. The theory of participative budgeting is suitable to this study as it describes how the composition of a budget should be in an agency relationship. Executive committee in state-owned corporation and cabinet of National level act as the agent and legislative members and parliament act as the principal while employees and public being participants. Budget quality depends on how the process is coordinated.

2.1.1 Theory of Inspired Confidence

This theory was developed in the 1932 by Dutch professor known as Theodore Limperg. The main aim was to address the demand and supply of quality financial statements that inspires stakeholders of organizations. Stakeholders of enterprises demand accountability from the management, in return for their investments in the organization. This calls for an effective approach when preparing financial statements that is based on experience and expertise. This contributes in confidence among stakeholders and those mandated with financial responsibilities. Therefore, financial statements and regulations must be in place to help manage confidence role. According to Limperg(1932),confidence make stakeholders gain trust and do business with the enterprises. It is an inspiration to ensure accountability is continuous and on record. According to Limperg(1932),confidence will make investors to gain trust and do business with the firm. It is an inspiration to ensure accountability is continuous and on track. This theory was brought on board by Okpala (2015) in Nigeria while studying on audit quality practices. In his study audit committee should be well structured to inspire confidence among users of financial information and more so win investors. Similarly, Kabiru et al. (2018) in his study established that quality financial reporting is associated with competence financial statements prepared by competent people and which can detect material misstatements and improve level of accountability. The theory is suitable for this study as quality financial statements prepared by competent staff and adhere to laid down regulations, inspires and provide confidence to all stakeholders of organizations.

2.1.2 Agency Theory

This theory was first proposed by Stephen Ross and Barry Mitnick who used it independently and almost concurrently. Ross originated the economic theory of agency theory while Mitnick championed the institutional theory of agency. Agency theory is extensively applied in accounting literature to explain an agency relationship that exists by default when one person is employed to manage another person’s financial matters. According to the Jensen and Meckling (1976), agency theory is a relationship between the principals such as shareholders and agents such as company executives and managers. The shareholders who are the principals and owners of a company, hires or delegates the agents to run the business on their behalf. This study will adopt agency theory to explain and predict the existence of accountability in state-owned corporations where the principle is the government and managers are agents who run the enterprise affairs to deliver the services to the public. Financial reports act for the interests of shareholders and therefore a properly functioning financial reporting system has a major role in forestalling a agency conflicts that may arise between shareholder and management. According to the agency theory accountability will be realized when conflicting interests are solved in good time, a role that can be effectively played by the financial reporting.

2.2 Empirical Literature

Makamanzi and Anockstate (2016) conducted a study in Zimbabwe on the impact of budgeting and budgetary control and performance of Great Zimbabwe University. The findings of the study revealed that there was no flexible budget structure, inadequate participation by the lower level in budget process, no communication of budget performance, low supervision from management and ineffective implementation of budgetary. The study recommended that the organization need to adopt a flexible budget structure, allow low level managers to participate in the budget making process, ensure effective implementation and communication of budget performance. This study was conducted in institution of higher learning in Zimbabwe whose operation and management of the operations and management of resources may differ from that of state-owned corporations as focused in the present study.

Albedal *et al. (*2020) studied the relationship between quality of financial reports and financial performance of Bahrain Stock Exchange listed firms. The study concentrated on the quality of earnings and audit committee as independent variables. The finding of the study revealed positive and significant in relation to ROA measures of financial performance. The study focused on Baharain stock exchange while the present study will concentrate on state owned corporations in kenya

Tuusandi and Puspitasari,E (2015) assessed the relationship between international financial reporting standard and financial performance of firms. IFRS used audit committee and earnings quality as its key variable that had positive significant effect on performance of firms. The study failed to highlight the element of financial reporting practices and concentrated on standards. Ojeka *et al*.(2015) examined financial reporting quality in manufacturing sector and found that financial reporting quality lacked influence on performance .Performance was also assessed using return on assets. The study focused on manufacturing firms while the current study will concentrate on state owned corporations in kenya.

Odero (2019) conducted a study on budget control uses and financial performance in public universities within Nairobi County. The study used descriptive statistics to analyze the data. The finding revealed that budget planning, budget coordination and budget control significantly affected the financial performance in Kenya public universities. The study also noted declining financial performance in public universities and requires considering budget control as a measure for utilizing, monitoring, and controlling costs within the budget for the accounting period provided. The current study will use both descriptive and inferential statistics to analyze data.

Nderitu (2018) assessed the effect of public sector accounting standards of financial reporting on the county Government in central region of Kenya. The study established that standardizing of financial reporting greatly enhances budget information reporting in the public sector in Kenya. The study further concluded that financial reporting in devolved units of Kenya has been improved by adoption of IPSAS. The methodology used in the study was survey research design while the present study will use exploratory research design. The study focused on county government of Kenya while the present study will concentrate on state owned corporations.

Limo (2018) assessed financial reporting practices and their influence on financial performance of SACCOs in Uasin Gishu County. The finding revealed that, adoption of IPSAS greatly enhances accountability and comparability of financial statements and boost the reliability of accounting information which are used for making decisions by end users. The financial report reforms evaluated based on adoption of IPSAS ensures books of accounts are properly maintained, adequacy and timely preparation and submission of consolidated financial statements. The study recommended that there is need to improve the quality of financial reporting practices and standards to improve financial performance of saccos in Uasin Gishu. The study concentrated on saccos in Uasian Gishu county while the present study focusses on state owned corporations in kenya.

Karungani and Onchiri (2017) investigated the effects of policy and regulatory framework on organization performance in Nairobi County. The study revealed that adoption of policy and regulatory framework led to the improvement of organizational performance by creating a level playing field for organizational in the procurement fields, improvement in transparency, openness, improved ethical standards, impartiality and improving decision making. The present study will utilize exploratory research design to establish the relationship between public financial reporting practices and accountability of state-owned corporations in kenya.

2.3 Conceptual Review

2.3.1 Public Financial Reporting practices.

Financial reporting has its basis in Article 226 of the constitution of Kenya which mandate parliament to enact laws to guide the practices. The act provides that all state-owned organization should publish their information related to financial reporting. It involves adhering to standard practices and the disclosure of financial information to various stakeholders regarding the financial performance and financial position of an organization over a specified period (Dewi et al., 2019). Financial reporting practices are critical pillars that enhance transparency and accountability in corporate, institutional governance, accounting principles and practices. Quality financial information is required to be relevant, comparable, timelines, disclosure, faithfully represent what it ought to represent, capable of detecting errors and prevent frauds from taking place. Proper adoption of financial reporting practices ensures that, the organizations utilize the resources allocated to them effectively and efficiently to attain its objectives. (Nyakundi, 2014). The nature of financial reporting in state owned organization have been detailed by Auditor general's reports. The reports of Auditor general released in 2022 revealed that there is weak financial controls and inadequate failure to account for spent funds by state owned organization which is contributing to rampant misuse of public resources (Auditor general report, 2022).

2.3.2 Regulation practices

Regulations are issued by government and its agencies to guide in Preparation of financial statements for public entities and has its basis rooted in Article 226 of the constitution which mandates the Auditor general to examine financial records of state-owned organizations. These guidelines direct how public resources are allocated and accounted for by public institutions (Nkwagu et al., 2016. Regulations ensures a systematic, independent, and objective verification of data, statements, records, operations, and projects. Financial regulations are used by the government to monitor, implement and maintain the integrity of the financial system in its institutions. The nature and extend of adherence to regulations by state owned organization has been detailed by Auditor general's reports released in 2022. Auditor general's reports released in 2022 revealed that the government has enacted various laws and regulations to deter and prevent corruption, but corruption continues to be witnesses in state owned corporations to date (Auditor general report, 2022).

2.3.3 Accountability

Accountability is, the ability of decision makers to be answerable, report, explain, and justify their actions (Zahara, 2021).Accountability is also the way, leadership in state owned organizations, manage normative, cultural, and professional expectations (Zahara, 2021).This study will examine the indicators of accountability such as timeliness of statutory reports, implementation of budget, quality of service delivery, number of completed projects and feedback system that have been put in place by the state owned organizations.

3. Proposed Conceptual Framework

The study proposes the following conceptual framework to assess and explain the relationship between financial reporting and its impact on accountability in state-owned organizations. The model proposes financial reporting practices as independent variables and is composed of budget, financial statements, staff competencies, IFMIS, Regulations and corporate financial governance practices and their relationship on accountability of state-owned organizations in Kenya which is dependent variable. The model is summarized in the figure bellow.

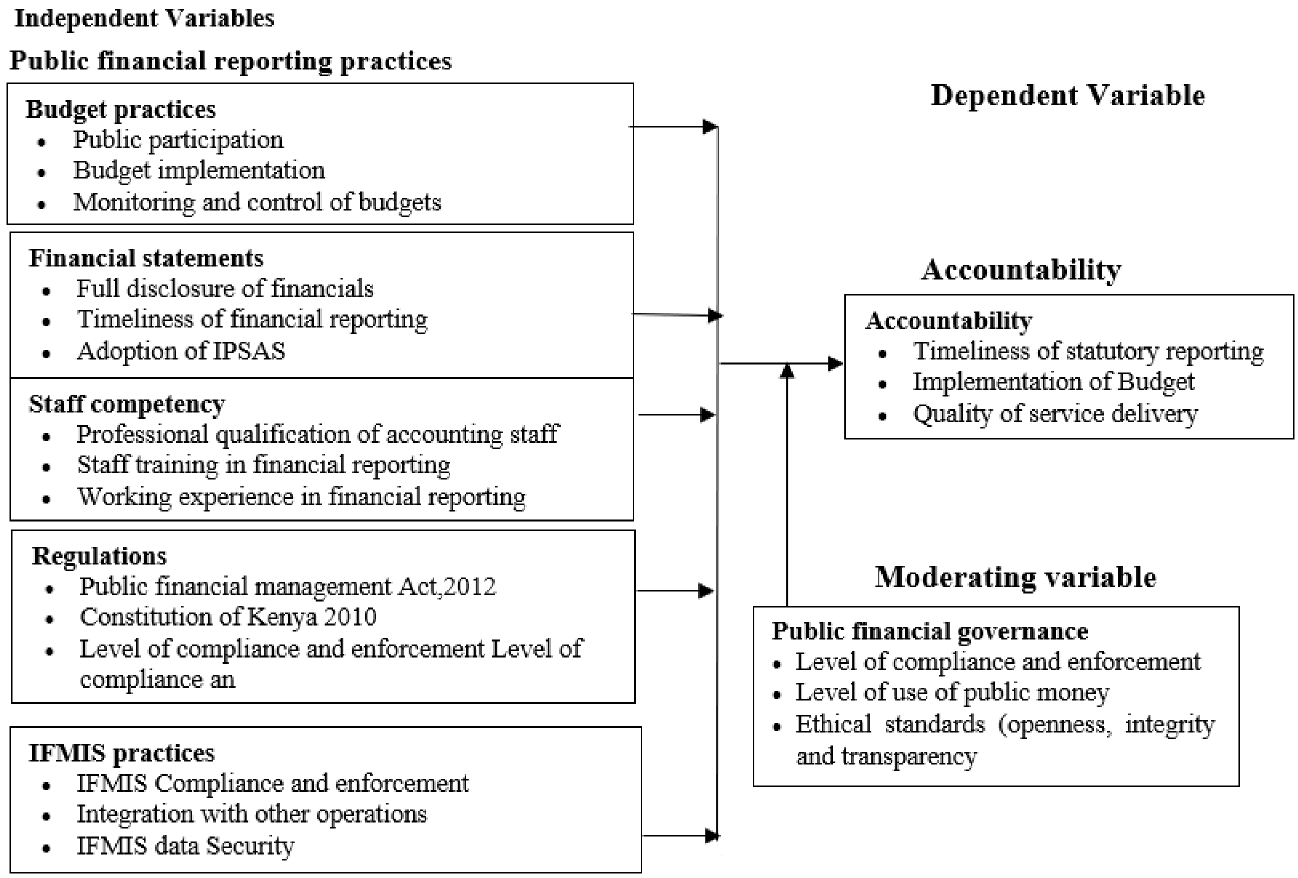

Figure 1.1: Proposed theoretical model.

Source: Researcher (2024

4. Methodology

This study adopted exploratory research design to assess the nature of financial reporting and regulation practices in the state-owned corporations of Kenya. Gummesson (2006) emphasizes that exploratory research allows researchers to deal with complex situations that has many actors and versed interests such as financial reporting and regulation in state owned corporations in Kenya. The study's target population is 187 government owned corporations in Kenya. A sample of 127 firms will be selected using a stratified random sampling technique. A data collection instrument is a mechanisms used to obtain data (Creswell, 2003).A secondary data collection tool commonly referred as document analysis shall be used to assemble financial year data between 2018 and 2022.Specifically, the research shall rely on scholarly journals, the Kenya constitution, State owned policy documentations, Auditor General's report and budgeting in Kenya, media reports and news stories on state owned organizations such as corruption, spending, investments, employments and independent state owned corporations websites and Google search engine to make its deductions.

5. Conclusions and Recommendations

5.1 Conclusion

Financial reporting is used by many organizations across the globe to mitigate against financial risks, uncertainties and enhance their business objectives and accountability. Financial reporting practices in state-owned corporations in Kenya is a statutory requirement which produce statements from accounting information that is used by oversight bodies that include, Office of the Controller of Budgets (OCOB), commission for revenue Allocation, Kenya National Audit office, donors, public institutions, management, and the government (Rugutt. W. Naibei, I.Dr.& Cheruiyot, K.P. Dr,2019).

5.2 Recommendations

There is need for state-owned corporations to employ staff who are qualified and experienced in technical matters related to accounting and financial reporting to run the accounting and finance departments. State-owned organizations should ensure that those who are charged with financial reporting matters are provided with relevant information to help in preparation of reliable financial reports. State-owned corporations should to put in place mechanisms that can share and discuss financial reports with public and other stakeholders. It is also recommended that the oversight bodies should strengthen the sanction enforcement mechanisms to punish those who are found engaging in financial malpractices (Gaitho, P.R.,2018).

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