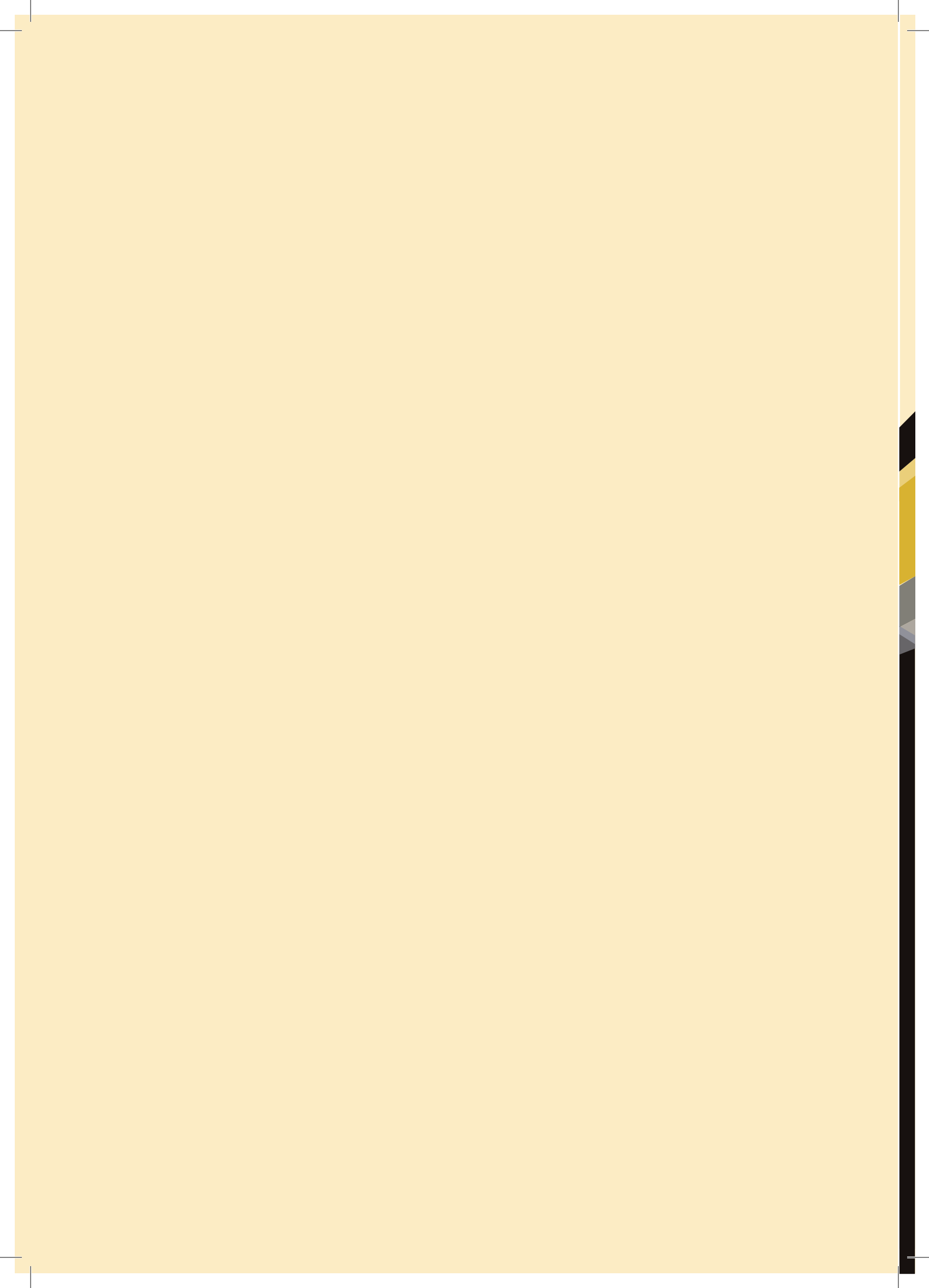




# **BASELINE STUDY ON READABILITY AND UNDERSTANDABILITY OF FINANCIAL STATEMENTS IN KENYA**

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BASELINE STUDY  
ON READABILITY  
& UNDERSTANDABILITY  
OF FINANCIAL STATEMENTS  
IN KENYA



2022

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# Foreword



**CPA Edwin Makori**  
Chief Executive Officer  
Institute of Certified Public  
Accountants of Kenya



**Prof. Isaac Nyamongo**  
Deputy Vice Chancellor  
Cooperative University  
of Kenya

The Institute of Certified Public Accountants of Kenya (ICPAK) is mandated to develop and regulate the Accountancy Profession in Kenya and, to promote research into the subjects of accountancy and finance and related matters, publish books, periodicals, journals and articles in connection therewith. It is on this basis that the Institute in collaboration with the Cooperative University of Kenya (CUK) through its Academics, Co-operative Development, Research and Innovation Division (ACDRI) undertook to conduct this study. The ACDRI Division is responsible for establishing and maintaining strategic linkages and partnerships with the industry to promote best practices through training, research and information sharing.

The Baseline Study on Readability and Understandability of Financial Statements in Kenya is a first in terms of collaboration between CUK and ICPAK and has generated invaluable insights on the extent to which users read and understand financial statements as well as providing crucial observations on the interventions of preparers and regulators in enhancing the readability and understandability of financial statements in Kenya.

Indeed, whilst the text has held it that the annual reports of firms. Companies and institutions and their attendant financial statements have always been one of the most important resources for decision-making, financial scandals continue to rock investors globally. The information asymmetry between the users and the management or board of directors has been identified as one of the root causes and forms the basis upon which this study was conducted.

The study has yielded crucial insights on the user needs and the interventions of preparers and regulators in enhancing the readability and understandability of financial statements in Kenya.



# Acknowledgement



The Institute together with the Cooperative University of Kenya acknowledges the selfless commitment of numerous individuals who dedicated time, expertise and diverse resources to see the completion of this research study. This study has been made possible through encouragement and support from various contributors from whom we are greatly indebted.

I acknowledge CPA Edwin Makori, the Chief Executive Officer and the team led by CPA Dr. James Ndegwa from Co-operative University of Kenya and Hillary Onami from ICPAK including Elias Wakhisi, CPA Dan Mugo, CPA Cliff Nyandoro, CPA Rahab Ntoiti, CPA Sheila Kemunto, Evans Juma, CPA Mary Boyani (Zamara - Kenya), Daniel Kiuna (Jitegemee Sacco), Nancy Moraa, Everlyne Maingi, Winnie Nkatha and Sheila Mwathi for the excellent conceptualizing and conducting of this study.

The report benefited immensely from valuable inputs from many respondents drawn from the preparers of financial statements, a majority of whom are ICPAK members, the users of the financial statements and the Regulators including the Central Bank of Kenya (CBK), the Capital Markets Authority (CMA), the Public Sector Accounting Standards Board (PSASB), the SACCO Society Regulatory Authority (SASRA), the Insurance Regulatory Authority (IRA), the Retirement Benefits Authority (RBA), the Unclaimed Financial Assets Authority (UFAA) among others for their time, energy and insights without which, this study would not have been possible.

We are also grateful for the input received from the members of the Research and Development Committee led by CPA Dr. Elizabeth Kalunda and FCPA Dr. Nicholas Letting' and the Public Policy and Governance Committee of which I chair and co-convened by CPA Philip Kakai for their supportive role in the study.

Last but not least, substantial resources and time have been spent on this project. We express our sincere gratitude to all the stakeholders and institutions which participated in various stages of the development of this study for their invaluable input, support and collaborations which went a long way in enriching the study.

To all of you I say, "Thank you!"

**FCPA George Mokua**

*Chairman - Institute of Certified Public Accountants of Kenya*





# Abbreviations

CBK	Central Bank of Kenya
CFO	Chief Finance Officer
CMA	Capital Markets Authority
COP	Conference of Parties
ERP	Enterprise Resource Planning
GOK	Government of Kenya
IAS	International Accounting Standards
ICPAK	Institute of Certified Public Accountants of Kenya
IFAC	International Federation of Accountants
IFMIS	Integrated Financial Management Information System
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
IRA	Insurance Regulatory Authority
MSME	Micro, Small and Medium Enterprises
NCPWD	National Council for Persons living With Disability
NGO	Non-Governmental Organization
NSE	Nairobi Securities Exchange
OAG	Office of the Auditor General
PPOA	Public Procurement Oversight Authority
PPRA	Public Procurement Regulatory Authority
PSASB	Public Sector Accounting Standards Board
RBA	Retirement Benefits Authority
SACCO	Savings and Credit Cooperative Society
SASRA	SACCO Societies Regulatory Authority
SDG	Sustainable Development Goals





# Executive Summary

Financial statements are prepared by the management of firms who possess much more knowledge than the users or readers of the financial statements. The readers depend on the managers to prepare financial statements that give a true and fair view of the state of affairs of the firm. There is thus an imbalance between the information possessed by the preparers and the readers, and that imbalance is referred to as information asymmetry. Past related studies have yielded evidence of obfuscation practices especially if financial statements do not present positive financial performance. Despite the numerous studies on the readability of financial statements in developed countries in the West, there is a dearth of related studies in emerging economies located in sub-Saharan Africa like Kenya. This study hence, sought to investigate the readability and understandability of financial statements of Kenya.

The study employed a descriptive research design and collected data from preparers, regulators and users / readers of financial statements in the six months period from November 2021 and April 2022. The Naissuma (2000) and Cochran (1977) sample size determination formulas were employed to derive a sample consisting of 1480 preparers, 2528 users of financial statements and 6 regulators. The research employed purposive sampling technique that allowed

expert selection of financial statement preparers and users as respondents to semi-structured questionnaires that were used for data collection. An interview guide was employed for data collection from the 6 regulators who consisted of the Central Bank of Kenya (CBK), Insurance Regulatory Authority (IRA), Capital Markets Authority (CMA), SACCO Societies Regulatory Authority (SASRA), Retirement Benefits Authority (RBA) and the Institute of Certified Public Accountants (ICPAK).

From the users perspective, the study found that the higher the number of years of interacting with financial statements, the higher the degree of readability and understandability by users. From the survey, the majority of the users of financial statements were men, implying that more men are likely to be in charge of financial decision-making as compared to women. It further established that the most active users of financial statements are aged 31-50 years. This conforms with the National Population Council of Kenya report of 2020 that categorizes this group as the most active population in the Kenyan economy.

The study observed that, 69% of preparers include a summarized version when publishing financial statements, 54% a comprehensive glossary in the financial statements, 87% indicated sharing of financial statements with



their shareholders within the stipulated time and 61% of preparers consider users' level of education when preparing financial statements.

In terms of comprehension of financial statements, it was established that many users found the financial statements complex and difficult to comprehend. The study also found that there are unaligned statutory requirements on preparing and publishing of financial statements, hence the need to enhance readability and understandability of financial statements. Printing and posting of financial statements should be considered in cases where there is no internet network or where the shareholders have placed

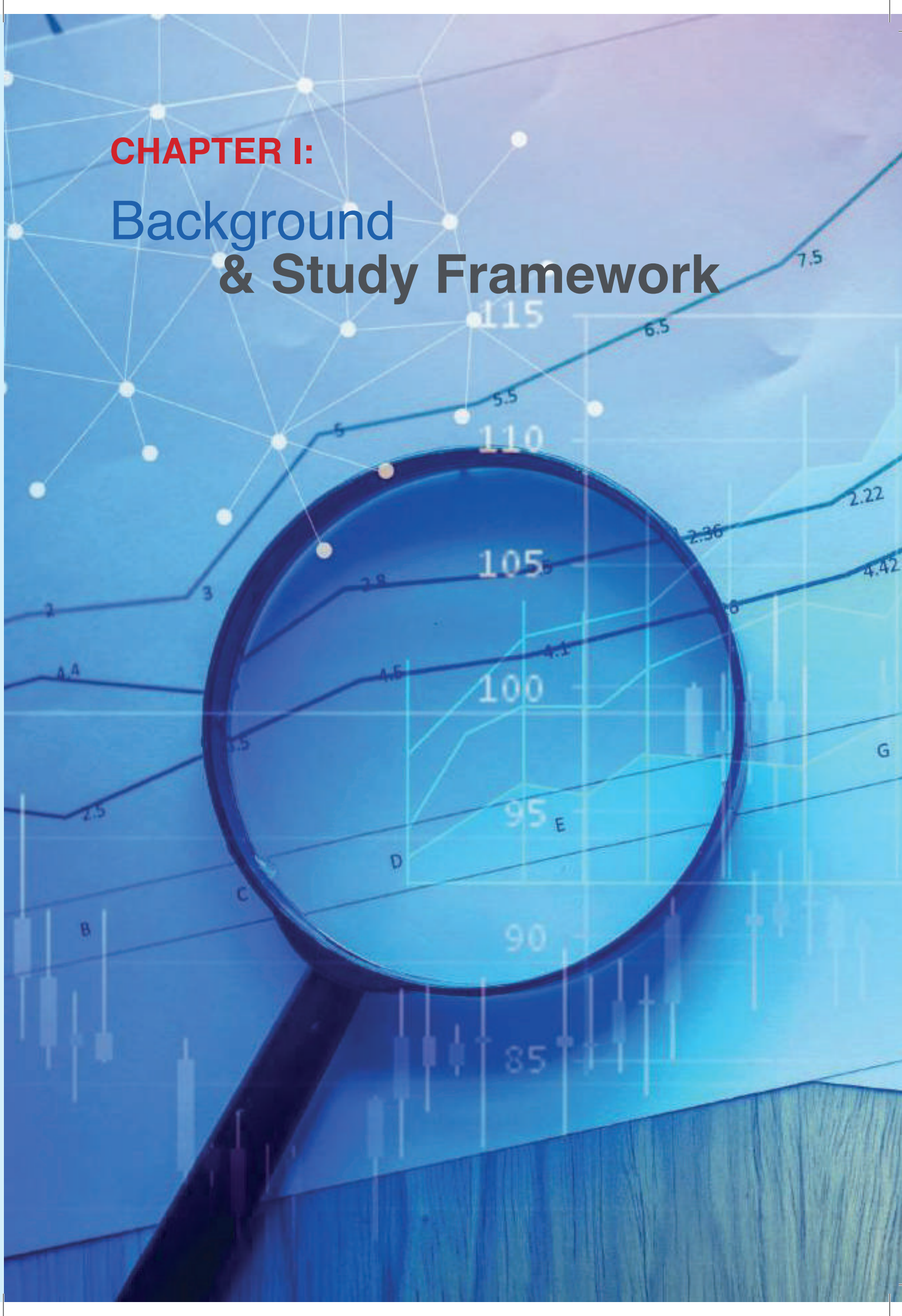
a request for printed financial statements to be posted to them.

To enhance readability and understandability of financial statements, it is important for entities to consider availing published financial statements on their websites, in addition to printed copies (hard copies). Further, entities should consider preparing simplified versions (without losing intended meaning) alongside detailed reports of financial statements. That said, it will be important going forward that entities conduct voluntary training of users on financial literacy, readability, and understandability of financial statements.



# CHAPTER I:

# Background & Study Framework



## BACKGROUND:

The annual reports of firms have always been one of the most important resources for decision-making of the capital market practitioners. Financial scandals globally are characterized by a situation where the management or board of directors acting on behalf of firm owners, have more information than the readers or users of financial statements who are vulnerable to exploitation for lack of adequate information. The management of a firm that is experiencing financial distress or similar challenges may deliberately obfuscate or obscure financial statements to hide the financial problems from the numerous readers or stakeholders who are not financial experts and if the financial performance is great the management may deliberately make it easy to read financial statements (Hassan et al., 2018).

The board of directors performs the key role in the governance of any company which includes the appointment and monitoring of the firm's top managers and the protection of shareholder interests and deployment of resources optimally in order to maximize shareholders' wealth (Sorin et al., 2017). The board also has the responsibility of ensuring that financial statements give a true and fair view of the state of affairs of the firm which implies that if there is an obfuscation of financial statements then the board cannot distance itself from it. In preparing the financial statements, the management needs to take into consideration the prescribed formats and standards and the provisions of the Companies Act. The board of directors is required to present at a general meeting, copies of its annual financial statements.

Effective communication of the financial performance of firms by management to stakeholders has been a challenging matter and it is important that the financial statement preparers understand the background knowledge of the readers for better communication. The misinterpretation of financial statement text by readers can lead to wrong and costly decisions and can even lead to job losses by management. In addition, wrong interpretation of financial statements can cause or mislead investors to invest in inappropriate and unviable investments or divest or not invest in viable opportunities. It is thus imperative for preparers of financial statements to effectively communicate a true and fair view of financial statements to the readers in a complete manner and on a timely basis (Satwinder et al, 2017).

The economic decisions that are taken by users of financial reports require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an entity to pay its employees and suppliers, meet interest payments, repay loans and make distributions to its owners. Users are better able to evaluate this ability to generate cash and cash equivalents if they are provided with information that focuses on the financial position, financial performance and cash flows of an entity. In respect of not-for-profit entities, ownership groups and contributors of donations are generally not concerned with obtaining a financial return but are usually more interested in the ability of an entity to achieve its non-



financial objectives, which in turn may depend upon the entity's financial position and financial performance.

The readability and understandability of financial statements are related terms but have different meanings. Readability refers to the linguistic characteristics of a text and impacts on the ease with which a reader can be able to read and understand the text. A text is deemed to be readable if a reader understands the intended message of a text upon reading it for the first time. Readability of financial statements and reports is an application of computational linguistics in finance and accounting (Xu et al, 2018). Readability level of a text is an indicator of the textual difficulty, and it is also an indicator of the suitability of the text to the characteristics of readers in terms of experience, academic and professional qualifications. Readability is fixed for a given text and is not varied by reader characteristics.

Understandability of the text or financial statements on the other hand is a reader's ability to make meaning of the financial statements and is thus affected by the reader's characteristics such as interests, background, prior knowledge, and readability (Wissing et al., 2016). Understandability refers to the classification, characterization, and presentation of financial information clearly and concisely by preparers so that readers can easily comprehend that information. This concept assumes a reasonable knowledge of business by the reader but does not require advanced business knowledge to gain a high level of comprehension.

To be understandable, information should be presented using the following guidelines:

- 1. Completeness.** The text presented should not be missing any key information. For example, a table of future lease payments should include all future periods for which lease payments will be made, so that a reader can understand the entire scope of future obligations.
- 2. Conciseness.** Do not bury the users of financial information with an excessive amount of detail. This means presenting a sufficient amount of information that is easily scanned for highlights. Also, do not replicate disclosures throughout the financial statements; instead, set forth information in one place, and then insert references to it elsewhere in the financial statements, as needed.
- 3. Clarity.** Use a presentation methodology that is easy for the reader to scan. This typically means that charts and tables take the place of text or are at least the preferred form of presentation.
- 4. Organization.** The reader should be able to easily locate cross-referenced information within the financial statements. This means that all supporting schedules should be identified with a footnote number or letter, with this identifier listed in the main financial statements.



Understandability assumes that even knowledgeable people may sometimes require the services of an expert/advisor to understand complex economic phenomena. Complex information should thus not be excluded from the financial statements even if it is not easy to understand. In these situations, apply the understandability concept as much as possible, but still present the required

complex information to the readers of financial statements. For information to be easily understandable, advanced users receive the more sophisticated and comprehensive material they require and users with a lower level of accounting knowledge are presented with material that is more immediately accessible (Kumar, 2014).





# Legal Background



## 1. The Companies Act, 2015

Section 114 (3) provides for the right of members to be sent a copy of the company's annual financial statements and reports. Section 115 provides for the right to receive a copy of all communications that the company sends to its members generally or to any class of its members that includes the person making the nomination; the right to be sent copies of the company's annual financial statement and reports; the right to receive a hard copy version of a document or information provided in another form.

Section 635 provides that directors of every company shall prepare individual financial statements for the companies for each financial year.

Sections 667 – 668 of the Act highlights the various forms and information to be contained in a summary financial statement. These are: a) statement of financial position; b) income statement; c) cash flow statements; d) Statement of changes in equity; e) A statement that it is a summary of information derived from the company's annual financial statements and the directors' remuneration report; f) A statement that indicates how a person is entitled to the Company's annual financial statement, director's remuneration report or director's report can obtain full copies of the same; g) A statement on whether the auditor's report on the annual financial statement was unqualified or qualified. If qualified, it should set out the report with any further material needed to understand the qualification.

Further, Section 670 of the Act obligates quoted companies to make annual financial statements available on their

website. Section 670 (2) and (3) of the Companies Act makes it an offence for a quoted company to fail to post the annual financial statements and directors' report of the company, and each officer of the company who is in default, commits an offence and on conviction are each liable to a fine not exceeding KShs. 500,000. Section 679 provides that the directors of a public company shall present to the members at a general meeting the copies of financial statements and reports.

## 2. Public Finance Management Act, 2012

Section 68(k) of the Act stipulates that accounting officers for national government entities, Parliament and the Judiciary shall prepare annual financial statements for each financial year within three months after the end of the financial year and submit them to the Controller of Budget and the Auditor-General for audit, and in the case of a national government entity, forward a copy to the National Treasury.

Section 194 of the Act mandates the Accounting Standards Board to provide frameworks and set generally accepted standards for the development and management of accounting and financial systems by all State organs. The Board also prescribes formats for financial statements and reporting by all state organs and public entities. The Board may set different standards for different categories of entities to which these standards apply including developing the content, structure and format of county frameworks and accounting and financial guidelines which are in line with the setting of county standards.



### **3. Sacco Societies Act, 2008**

Section 42 of the Act requires that the disclosures in the financial statements of a Sacco society shall include disclosures on members if any, who hold more than twenty percent of the share capital and deposits in the Sacco society; any advances or credit facilities exceeding such limits of its core capital as may be prescribed by the Authority; and any lending to insiders. Section 46 (1) further provides that a Sacco society shall display, throughout the year, in a conspicuous position in every place of business, a copy of its last audited financial statements in the prescribed format.

### **4. Insurance Act (CAP 487)**

The Act in Section 61(1) provides that every account, balance sheet, certificate, return or statement required to be prepared or prepared shall be deposited with the Commissioner within three months after the end of the period to which they relate: provided that the insurer shall cause a copy of the audited balance sheet deposited with the Commissioner to be published in at least two daily newspapers of national circulation, within thirty days of such deposit.

### **5. Banking Act (CAP 488)**

Section 22 of the Act provides that every institution shall: exhibit throughout the year in a conspicuous position in every

office and branch in Kenya a copy of its last audited financial statements which shall conform with the minimum financial disclosure requirements prescribed from time to time by the Central Bank together with the full and correct names of all persons who are officers of the institution in Kenya; and within three months of the end of each financial year, cause a copy of the balance sheet and last audited income statements for that financial year to be published in a newspaper with wide circulation.

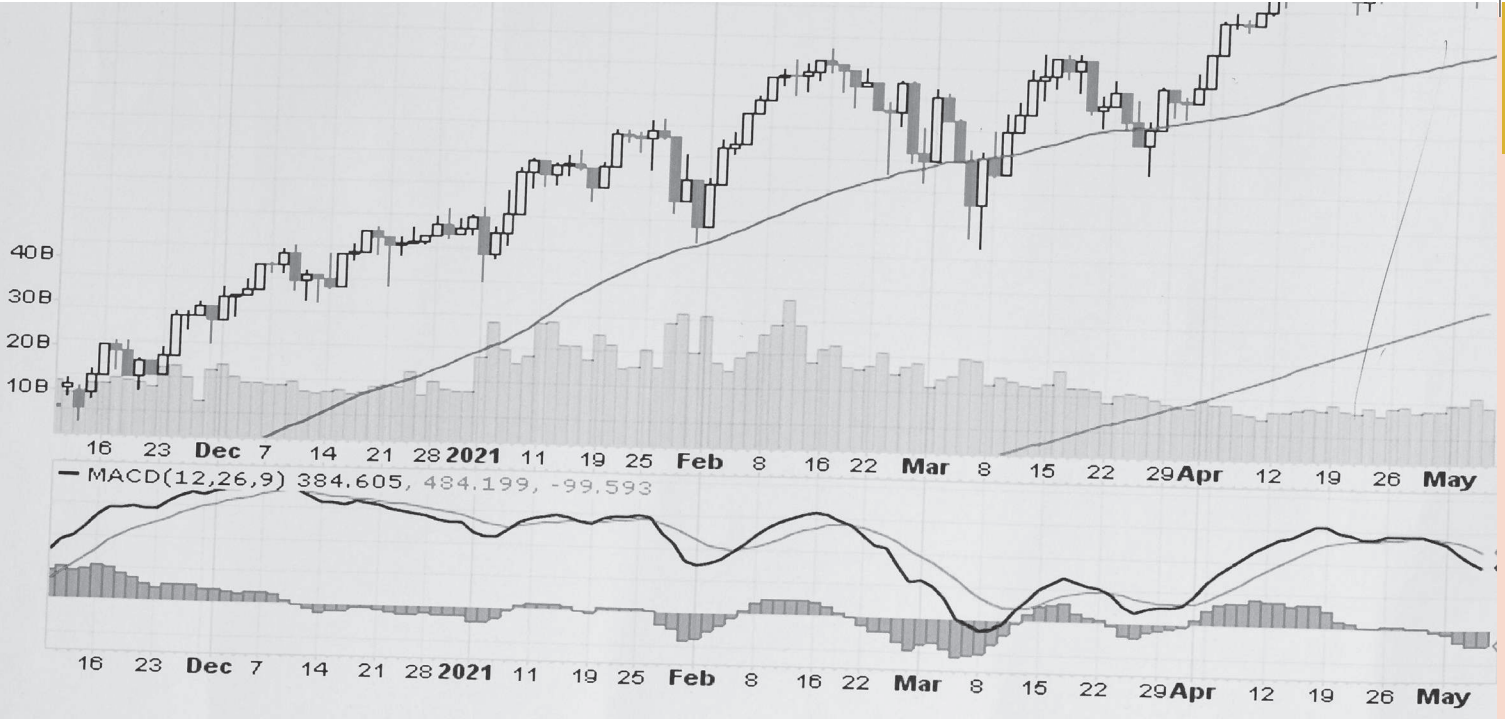
### **6. Microfinance Act, 2006**

Section 31 (1) of the Act provides that an institution shall exhibit, throughout the year, in a conspicuous position in every office and branch, a copy of its last audited financial statements and shall, within four months of the end of each financial year, cause a copy of the balance sheet and profit and loss account for that year to be published in a national newspaper, in such form as the Central Bank may prescribe.

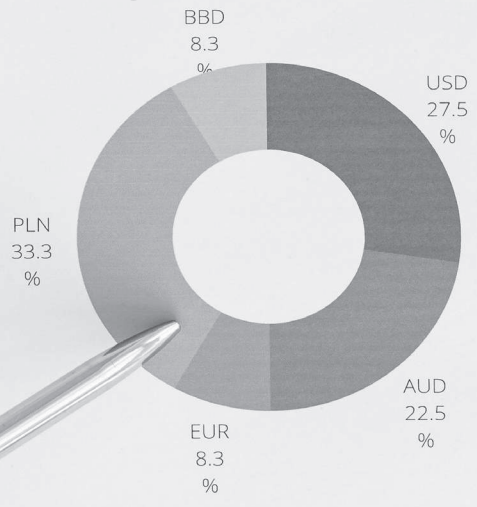
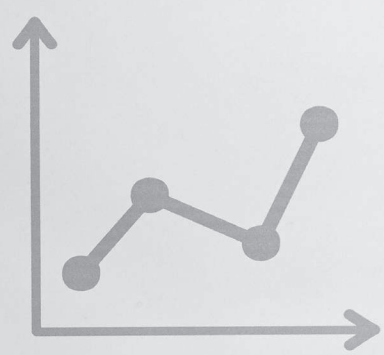
### **7. CMA Guidelines**

The Capital Markets Authority, Kenya recommends the preparation of quarterly reports and interim reports in full compliance with the International Accounting Standards and the International Financial Reporting Standards (IFRS).





# Problem Statement



In the past few years, there have been various cases of closure of retail supermarkets, the collapse of banks, investment schemes, SACCOs and other entities in Kenya. This has been attributed to the improper presentation of the financial statements and financial illiteracy among the investors. Given the low levels of financial literacy among Kenyan investors and users of financial statements especially the vulnerable groups such as women, youth and persons living with disabilities and the disconnect between the preparers and users of financial statements, the users of financial statements are at great risk of being deceived and manipulated by the financial statement preparers who have more information. Past studies have indicated that financial statements containing poor financial performance are likely to be deliberately obfuscated in to conceal the poor performance and thus may not give a true and fair view of the firm's state of affairs (Bloomfield, 2002).

When financial statements are difficult to read investors are at risk of making inappropriate investment decisions that can lead to heavy losses. The exploitation of less informed persons by parties with more information is referred to as information asymmetry (Stiglitz, 2000). The research thus seeks to find out the ease of readability of financial statements in Kenya and whether users of financial statements feel exploited by the preparers. Section 1015 of the Companies Act requires companies to

supply financial information through hard and electronic means. This is an improvement to the requirement of physical printing and posting of financial statements to shareholders of public companies which was a wasteful exercise since the target user groups are generally financially illiterate.

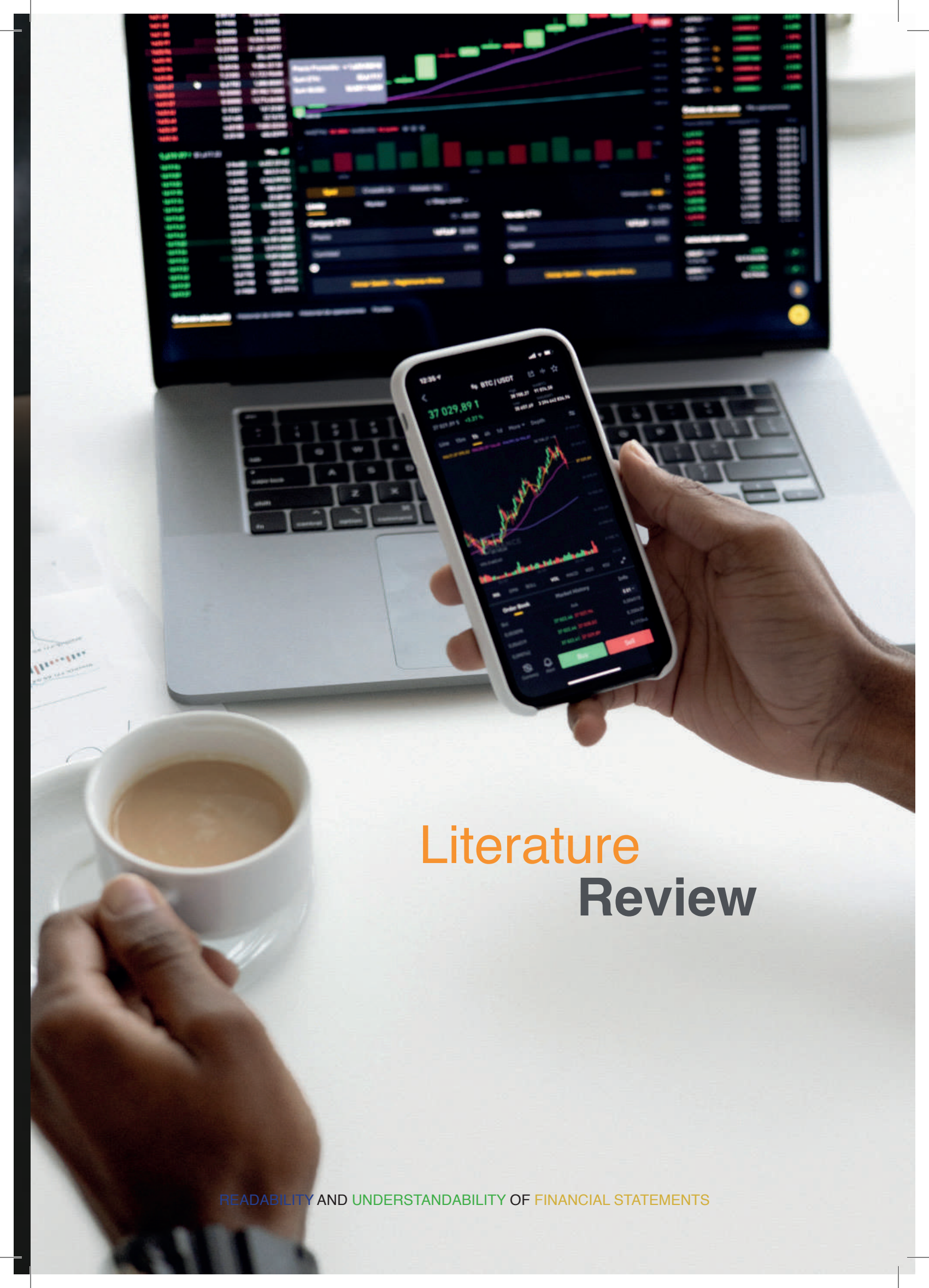
There was a contextual gap whereby the readability of financial reports had been studied widely with many researchers collecting and analyzing secondary data in developed countries. Zurel (2014) studied the readability of financial reports in Belgium, Badawy and Ibrahim (2018) studied the readability of financial reports in Egypt, Cheung (2014) studied the readability of financial reports in Australia, Wissing et al. (2016) in South Africa. Xu et al. (2018) studied the readability of financial statements in the US. There has been no substantive study in emerging sub-Saharan countries. Methodological research gaps arose in relevant past studies with past related studies mainly employing inferential statistical analysis of quantitative data as per Xu et al. (2018); Cheung (2014); Zurel (2014); Hassan, Abbas. and Garas (2019).

This study was carried out in an emerging sub-Saharan country and employed descriptive analysis using quantitative and qualitative data that were collected through semi-structured questionnaires and interviews with regulators, preparers and users of financial statements in Kenya.



## OBJECTIVES

1. To investigate the experiences and challenges faced by users in the reading and understanding of financial statements in Kenya.
2. To assess the experiences, challenges and interventions faced by preparers in the preparation of financial statements in Kenya.
3. To obtain insights from the regulators on the readability and understandability of financial statements in Kenya.
4. To propose policy interventions to enhance the readability and understandability of financial statements in Kenya.



# Literature Review

This section entails a review of theoretical and empirical literature that support the variables of the study (readability and understandability of financial statements).

## **THEORETICAL LITERATURE REVIEW**

### **The incomplete revelation Hypothesis/ Theory**

According to the incomplete revelation or obfuscation theory as proposed by Bloomfield (2002), managers are more satisfied when presenting reports displaying good performance than when presenting reports indicating bad performance and hence have an incentive to manipulate financial statements to deceive readers. The theory depicts that, investors devote substantial resources to determining mispriced securities based on public data. Managers seek to boost security prices by hiding bad news in footnotes, and regulators may wish to defeat such efforts because the information that is hard to extract from financial statements will not be reflected in security prices (Bloomfield, 2002). The Incomplete Revelation Hypothesis supports the readability of financial statements variable in this research.

### **Information asymmetry theory**

According to the information asymmetry theory by Stiglitz (2000) and Spence (1973), if there is an imbalance in information possessed by two parties in a transaction, the party with more information is likely to exploit such excess information to the disadvantage of the counterparty in the transaction. In this study, if there is an imbalance between information possessed by management who are the preparers of financial statements and the information possessed by readers, the management

can easily take advantage of the excess information and manipulate the financial statements, especially during periods of poor performance. The information asymmetry theory expounds on the readability of financial statements variable in this study.

### **Zipf's law**

As per Zipf's Law, which was proposed by Zipf in 1935 to 1950, a small number of words tend to dominate the frequency of words used in reports and the most frequently used word in a report will occur twice as many times as the second most used word and three times as much as the third most frequently used. The law further opined that if one of these words is misclassified then the readability of the financial reports may be distorted (Turner et al. 2015).

Financial statements tend to use certain common words that may be deemed as complex by readability indices such as the Fog index (Lougran and Mc Donald, 2016). The Fog Index indicates that an increase in the number of complex words decreases readability. Zipf's law assumes that better written documents will produce less ambiguity. It opines that, if firms are trying to obscure relevant information, it is likely that they will use complex words and bury the results in longer documents. Further, litigation risk incentivizes managers to disgorge information whether it is useful or not. Therefore, Zipf's law helps researchers in conceptualizing the readability and understandability of financial statements.

## **Empirical Literature Review**

This section reviews literature that has been done by other researchers





on readability and understandability of financial statements.

Riley and Taylor (2018) studied the inconsistent effects of plain English disclosures on nonprofessional investors' risk judgement in the USA. Using experimental survey, the study collected information from 359 responses. It was found that there was no significant impact in judgments between plain English and less readable language on a firm's risk factor. The Riley and Taylor (2018) research did not study the readability of financial statements and was done in a developed country unlike this research which was done in the context of a developing country. Xu et al. (2018) studied executive age and the readability of financial reports in the US and assumed that financial report complexity is meant to hide or obfuscate the poor financial performance of firms. It assumed that older executives were associated with more truthful and ethical financial reports and that the contents of financial reports were less difficult to read. The Xu et al. (2018) study was carried out in a developed country unlike the present study which was done in the context of a developing country.

Jones and Smith (2014) conducted a study in Australia on traditional and alternative methods of measuring the understandability of accounting narratives. The study concluded that the Cloze test is a good measure of the predictability of accounting narratives, and of textual redundancy, as compared to the other two measures. The study investigated the methods for measuring the understandability of accounting texts used in the development of annual reports or prospectuses. The Jones and Smith (2014) study was similar to

Cheung and Lau (2014) which examined the association between the readability of financial disclosures, analysts' forecasts and International Financial Reporting Standards (IFRS) adoption in Australia. The objective of this paper was to assess whether more readable financial disclosures improve the decision-making of financial report users, in particular financial analysts who are a significant group of users. The study concluded that readability of financial statements had a positive relationship with analysts' forecasts and investments. The Jones and Smith (2014) and Cheung and Lau (2014) were similar to the study by Wissing et al. (2016) who studied the readability, comprehensibility, and lexical coverage in the evaluation of an introductory accountancy textbook in South Africa. These studies were carried out in developed countries while the present study was carried out in a developing country in sub-Saharan Africa.

Badawy and Ibrahim (2018) studied the effect of readability and complexity levels of financial disclosures on naïve investor decisions by carrying out non-parametric statistical tests in Egypt. The findings indicated that readability levels affected investors' stock valuation regardless of complexity of information. The Badawy and Ibrahim (2018) study was carried out in a northern African country and only focused on readability and not understandability of financial statements. The present study was done in a sub-Saharan country and focused on both readability and understandability of financial statements.

Kariuki (2013) conducted a study on institutional investors' perceptions on the quality of financial reporting



in Kenya. The study established that investors' main sources of information for Kenyan investors included company announcements, annual reports, financial analyst advisory, and newspapers, magazines and journals. Investors also regarded the most useful information had predictive value, feedback value and was timely. The study findings also indicated that the annual reports or

financial statements contained the most important information in companies. The information in company annual reports that were deemed most useful included non-current liabilities, total equity, turnover income, dividends per share, and earnings per share. Kariuki (2013) did not focus on the readability and understandability of financial statements in Kenya which is the focus of this study.



# Research Methodology



## RESEARCH DESIGN

In this study, descriptive survey research was used to assess the understandability and readability of financial statements and the extent to which individuals seek the services of professionals in the interpretation of financial statements. The design was used because it accurately and systematically described the characteristics and facts of the population under study (Siedlecki, 2020).

## POPULATION

The population consisted of 6 regulators, 23,374 financial statement preparers and an infinite number of users of financial statements in Kenyan entities. The users of financial statements can be shareholders, trade and loan creditors, government officers, employee unions, consumer and environmental groups and even competitors of the firms for which financial statements are prepared.

## SAMPLING AND SAMPLING SIZE

The study applied purposive sampling to determine the sample size. According to (Black, 2010), purposive sampling is a form of non-probability sampling which gives the researcher the discretion to use their own judgment to select a representative sample from the study population. Based on the sampling technique, the study obtained the following sample sizes from regulators, preparers, users and disadvantaged groups; 6 regulators, 484 preparers, 2528 users, and 1480 respondents from disadvantaged groups. The technique was considered the most appropriate for this study as it is cost effective and timely given that the study population was large. In addition, it led to better insights, more precise results, and better coverage of the target population.

## SAMPLE SIZE DETERMINATION

The population size of preparers and that of the members of disadvantaged groups was finite while the population size of the users of financial statements was infinite. The Cochran (1977) sample size determination formula was employed in the case of users as the population was infinite. This formula allows the calculation of an ideal sample size given a desired level of precision, desired confidence level, and the estimated proportion of the attribute present in the population.

The Naissuma (2000) sample size determination formula was employed in the case of preparers and members of the disadvantaged groups where the population size was finite. The Naissuma (2000) coefficient of variation formula is as follows:

$$S = \frac{N(Cv)^2}{(Cv)^2 + (N - 1)e^2}$$

Where:

S = the sample size

N = the population size

Cv = the Coefficient of Variation

e = standard error



According to the Nassiuma (2000) formula, the coefficient of variation that is in the range of  $21\% \leq C \leq 30\%$  is acceptable and a standard error that is in the range of  $2\% \leq e \leq 5\%$  is also acceptable. This study used a coefficient variation of 30% and a standard error of 2%. The higher limit coefficient of variation and lower limit standard error were selected to ensure low variability and minimal error.

### SAMPLE SIZE DETERMINATION FOR THE PREPARERS OF FINANCIAL STATEMENTS IN KENYA

**A) SACCO Societies Regulatory Authority (SASRA):** Regulator of Deposit Taking (DT) SACCOs (with the users of financial statements mainly being the SACCO members). There is a population of 175 preparers of financial statements in 175 DT SACCOs in Kenya licensed by SASRA.

$$N = 175 \quad C = 0.3 \quad E = 0.02$$

$$N = 175 * 0.32 / (0.32 + (175-1)0.022)$$

**Sample size (N) = 99** preparers of financial statements in DT SACCOs in Kenya

**B) Capital Market Authority (CMA):** Regulator of listed Kenyan companies (with the users of financial statements mainly being the shareholders of NSE listed companies). There is a population of 64 preparers of financial statements in the 64 companies listed in the NSE.

$$N = 64 * 0.32 / (0.32 + (64-1)0.022)$$

**Sample size (N) = 50** preparers of financial statements in NSE listed companies in Kenya.

**C) Insurance Regulatory Authority (IRA):** Regulator of Kenyan Insurance companies (with the users mainly being the shareholders of the insurance companies in Kenya). There is a population of 61 preparers of financial statements in the 61 licensed insurance companies in Kenya.

$$N = 61 * 0.32 / (0.32 + (61-1)0.022)$$

**Sample size (N) = 48** preparers of financial statements in insurance companies in Kenya

**D) Retirement Benefits Authority (RBA):** Regulator of preparers of financial statements in retirement benefits schemes in Kenya. There is a population of 32 preparers of financial statements in the retirement benefits schemes in Kenya.

$$N = 32 * 0.32 / (0.32 + (32-1)0.022)$$

**Sample size (N) = 28** preparers of financial statements in retirement benefits schemes in Kenya

**E) Central Bank of Kenya (CBK)** Regulator of Commercial Banks in Kenya. There is a population of 42 preparers of financial statements in the 42 licensed commercial banks in Kenya.

$$N = 42 * 0.32 / (0.32 + (42-1)0.022)$$

**Sample size (N) = 36** preparers of financial statements in commercial banks in Kenya.

**F) Institute of Certified Public Accountants of Kenya (ICPAK):** Regulator of preparers of financial statements in Kenyan firms. There is a population of 23,000 preparers



of financial statements who are also active members of ICPAK.

$$N = 23000 * 0.32 / (0.32 + (23000 - 1) * 0.022)$$

**Sample size (N) = 223** members of ICPAK who prepare financial statements

### **SAMPLE SIZE DETERMINATION FOR USERS OF FINANCIAL STATEMENTS WHO ARE ALSO MEMBERS OF THE DISADVANTAGED GROUPS IN KENYA**

A population of 6293 members under this category is established from the website of PPRA formerly PPOA.

$$N = Nc^2 / (c^2 + (N - 1) * e^2)$$

Where:

$$N = 6293 \quad c = 0.3 \quad e = 0.02$$

$$N = 6293 * 0.32 / (0.32 + (6293 - 1) * 0.022)$$

**Sample size (N) = 218** members of vulnerable groups in Kenya

### **SAMPLE SIZE DETERMINATION FOR USERS OF FINANCIAL STATEMENTS IN KENYA**

The Cochran (1977) formula for infinite population (over 10,000 users). The Cochran formula is as follows:

$$n_0 = \frac{Z^2 pq}{e^2}$$

**Where:**

- e is the desired level of precision (i.e. the margin of error),
- p is the (estimated) proportion of the population which has the attribute in question,
- q is 1 - p.

$$n_0 = 1.962^2 * 0.5 * 0.5 / 0.052$$

$$p = 0.5 \text{ (maximum variation)}$$

$$q = 1 - p$$

$$e = 0.05$$

$$Z = 1.96 \text{ (normal distribution)}$$

**Therefore;**

$$n_0 = 1.962^2 * 0.5 * 0.5 / 0.052$$

$$n_0 = 385 \text{ Users}$$

Hence the sample size (N<sub>0</sub>) = 385 for users of financial statements under in each of the 6 regulators in Kenya (SASRA, CMA, IRA, CBK, RBA and ICPAK)



## SAMPLE FRAME OF QUESTIONNAIRE RESPONDENTS

**Table 1: Sample Frame of Questionnaire Respondents**

Regulators	Population of Preparers / Users of financial statements per sector	Sample of Preparers of financial statements per sector	Sample of users of financial statements per sector from an infinite number of potential users of financial statements per sector
<b>SASRA (SACCO Society Regulatory Authority)</b>	There were a total of 175 Licensed SACCOs as at 21st January 2021 Source: SASRA website	99	385
<b>Capital Markets Authority (CMA)</b>	There were a total of 64 Listed Companies as at 9th August 2021 Source: Nairobi Securities Exchange	50	385
<b>Insurance Regulatory Authority (IRA)</b>	There were a total of 61 Licensed Insurances Companies as at 7th January 2021 Source: IRA	48	385
<b>Institute of Certified Public Accountants of Kenya (ICPAK)</b>	There were a total of 23,000 Active registered members as at 31st October 2021 Source: ICPAK	223	385
<b>Retirement Benefits Authority (RBA)</b>	There were a total of 32 Registered Retirement Benefits Administrators as at 2021 Source: RBA	28	385
<b>Central Bank of Kenya (CBK)</b>	There were a total of 42 Licensed commercial banks as at 9th August 2021 Source: CBK's website	36	385
<b>Members of disadvantaged groups in Kenya (women, youth and persons living with disabilities)</b>	There were a total of 6293 members of disadvantaged groups in Kenya (women, youth and persons living with disability who were potential users of financial statements) as at 30th June 2021 Source: PPRA (formerly PPOA) website	-	218
<b>Total population size of 6 regulators</b>	Total population size of 23,374 preparers of financial statements and infinite number of users of financial statements	Total sample size of 484 preparers of financial statements	Total sample size of 2,528 users (readers) of financial statements

## DATA COLLECTION

The study employed the primary data collection method to obtain first-hand information from the preparers, users and regulators of financial statements. Semi-structured questionnaires were administered to the 484 sampled preparers and the 2,528 sampled users of financial statements to obtain their opinions and experiences regarding their interactions with financial statements in Kenya. The semi-structured questionnaires were administered electronically to the respondents during a period of 6 months between November 2021 and April 2022. During the same period interviews were carried out for the 6 regulators using interview guides. The data obtained was analyzed in line with the study objectives.

The questionnaires targeting the users and preparers of financial statements were distributed to the respective regulator for onward distribution to the users under the regulator who employed the purposive sampling technique. The questionnaires targeting the members of vulnerable groups in Kenya were

distributed to the sampled respondents by the study researchers using the purposive sampling method. Since there were only 6 regulators, a census study was carried out for this group.

## AREAS OF DELIMITATION (SCOPE OF THE STUDY)

The study limited itself to opinions and perception of readers (users), preparers and regulators of financial statements in Kenya and thus collected primary data only using structured questionnaires and interview guides during 6 months period of November 2021 and April 2022. The preparers targeted in this study were ICPAK registered members across the 47 counties. This is because they have a better understanding of financial reporting standards, and they are provided with reporting templates in line with International Accounting Standards. However, the study did not limit itself in terms of users of financial statements since users are spread across various sectors.





## CHAPTER II:

# Users of Financial Statements



## Introduction

This subsection sought to answer the research question: what challenges do users face in reading and understanding financial statements in Kenya? It consisted of the following: the profile of the users of financial statement in Kenya, the extent of readability and understandability of financial statement by users, the extent and mode of accessing financial statements by the users and the challenges faced by the readers of financial statements and the recommendations.

In accounting, users or readers of financial statements are interested in financial information about an entity and entities must account for transactions

and balances and present the same in a manner that can be easily read and understood. Financial statements are of primary importance to the owners, management, investors, government, employee unions, creditors, competitors, scholars and the public in general.

Understandability of the information contained in financial statements is crucial in terms of relevance to the users as it helps them make informed economic and policy decisions. The International Accounting Standards (IAS) provide universal guidelines and templates for preparation, presentation and reporting of financial statements.

### Balance Sheet

	Current	Previous
<b>Assets</b>		
Current Assets	5,867	2,944
Non-Current Assets	18,386	12,932
<b>Total Assets</b>	<b>\$ 24,253</b>	<b>\$ 15,876</b>
<b>Liabilities</b>		
Current Liabilities	3,860	2,876
Non-Current Liabilities	11,873	8,200
<b>Total Liabilities</b>	<b>\$ 15,733</b>	<b>\$ 11,076</b>
<b>Shareholders' Equity</b>		
Equity Capital	6,498	4,180
Retained Earnings	2,022	620
<b>Total Shareholders' Equity</b>	<b>\$ 8,520</b>	<b>\$ 4,780</b>
<b>Total Liabilities And Shareholders' Equity</b>	<b>\$ 24,253</b>	<b>\$ 15,856</b>

### Income Statement

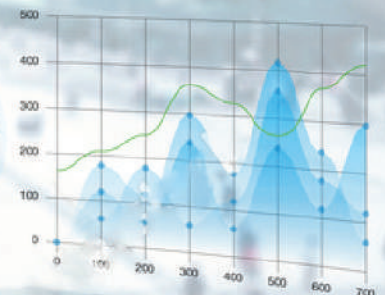
	Current	Previous
Net Sales	9,682	7,087
Cost of Sale	7,087	5,594
<b>Gross Margin</b>	<b>\$ 2,595</b>	<b>\$ 1,493</b>
Operating Expenses	1,099	345
Administrative Expenses	345	1,240
<b>Total Operating Expenses</b>	<b>\$ 1,444</b>	<b>\$ 1,585</b>
<b>Operating Income</b>	<b>\$ 1,151</b>	<b>\$ 2,108</b>
Income Tax	1,151	2,108
<b>Net Income</b>	<b>\$ 0</b>	<b>\$ 0</b>

### Cash Flow Statement

	Current	Previous
<b>Operating Activities</b>		
Net Income	1,241	212
Adjustments To Reconcile Net Income	1,450	365
Changes In Operating Assets And Liabilities	890	267
<b>Total Operating Activities</b>	<b>\$ 3,581</b>	<b>\$ 844</b>
<b>Investing Activities</b>		
Marketable securities	(270)	(42)
Property, plant and equipment	(891)	(151)
<b>Total Investing Activities</b>	<b>\$ (1,161)</b>	<b>\$ (193)</b>
<b>Financing Activities</b>		
Issuance Of Term Debt	3,077	1,450
Repayments Of Term Debt	(852)	(291)
<b>Total Financing Activities</b>	<b>\$ 2,225</b>	<b>\$ 1,159</b>

3%

1,594



## Users and Uses of financial information in Kenya

The table below illustrates the users of the financial statements and their respective needs.

**Table 2: Users and Uses of Financial Information in Kenya**

	Category of User	Information Need
1.	Prospective Investors and Shareholders	<ul style="list-style-type: none"> <li>Prospective investors are interested in financial statements to assess the viability and going concern of the entity</li> <li>Shareholders or members of the company as providers of capital, are concerned over the risk of investment and maximization of their wealth.</li> </ul>
2.	Employees/Unions	<ul style="list-style-type: none"> <li>Employees require relevant information on the going concern status of the organization, job stability, profitability of the organization, fair remuneration and fair of pension plans.</li> <li>Unions evaluate the ability of the entity to pay fair compensation and pension benefits to the members that they represent.</li> </ul>
3.	Lenders	<ul style="list-style-type: none"> <li>Are interested in the entity's creditworthiness and solvency.</li> </ul>
4.	Governments and their agencies including tax authorities and regulators	<ul style="list-style-type: none"> <li>As a guarantor of public interest, the government requires financial statements for purposes of accountability, regulation, taxation, monitoring and evaluation of programs.</li> </ul>
5.	Investment Analysts and Advisors	<ul style="list-style-type: none"> <li>To determine the company's viability for investment decisions.</li> </ul>
6.	Suppliers and Trade Creditors	<ul style="list-style-type: none"> <li>Interested to know whether clients can fulfill their financial and trade obligations.</li> </ul>
7.	Customers	<ul style="list-style-type: none"> <li>To assess the continuity of the business, product quality safeguards and its growth prospects.</li> </ul>
8.	Company Management	<ul style="list-style-type: none"> <li>To understand the profitability, liquidity, and cash flows of the entity so that it can make operational and financing decisions about the business.</li> </ul>
9.	Competitors	<ul style="list-style-type: none"> <li>To evaluate the financial position for comparative and competitive advantage.</li> </ul>
10.	Students, Researchers, Academia	<ul style="list-style-type: none"> <li>To gain insights into market dynamics, trends and performance of entities for purposes of learning, research, innovation, knowledge transfer, or information sharing.</li> </ul>
11.	Donors	<ul style="list-style-type: none"> <li>To determine the going concern of the company</li> <li>Compliance with the various guidelines by the regulators</li> <li>Fund utilization</li> </ul>



	Category of User	Information Need
12.	The Public	<ul style="list-style-type: none"> <li>• For information purposes, transparency and well-being of the society.</li> <li>• Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers.</li> <li>• Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.</li> </ul>

Given the vast number of users of financial statements, it is therefore important that the financial statements are prepared and presented in a manner that can be easily read and understood by all.

## FINDINGS

This section summarizes the research outcomes outlining how the demographic factors affected the users' understandability and readability of financial statements as well as the extent to which users seek professional help in interpreting financial statements.

### The profile of questionnaire respondents under the users' category

#### Demographics

The research sought information on financial statement users' age, education, physical capabilities, and their exposure to the financial statements. The following are the findings:

#### Gender of the respondents in the financial statements users category

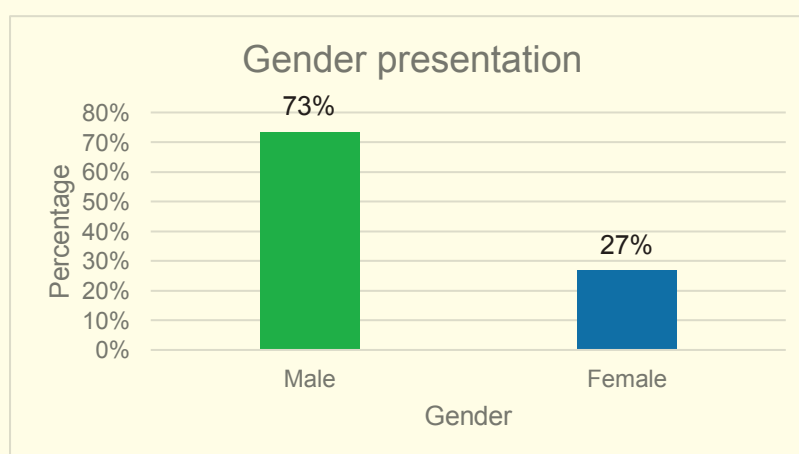


Figure 1: User Gender Representation



As per Figure 1, findings on the gender of the respondents, 73% of the respondents were male and 27% were female. These findings indicate that in Kenya, men have a higher interest in financial statements as compared to women, thereby placing them at the heart of financial decision-making as compared to their female counterparts. These findings are consistent with those of the World Bank which shows that more women globally are less likely to have an account with a financial institution or mobile banking compared to men and that the gap is even bigger in developing countries (World Bank, 2022). In addition, Morsy & Yousseff (2017) found that men have a higher interest in finance than women.

### Age of the respondents in the users' category

The study categorized the respondents in the ten-year ranges as shown below, 16% were between 21 to 30 years, 38% were between 31 to 40 years, 31% were between 41 to 50 years and 15% were above 50 years. The following bar graph is a representation of respondents age distribution.

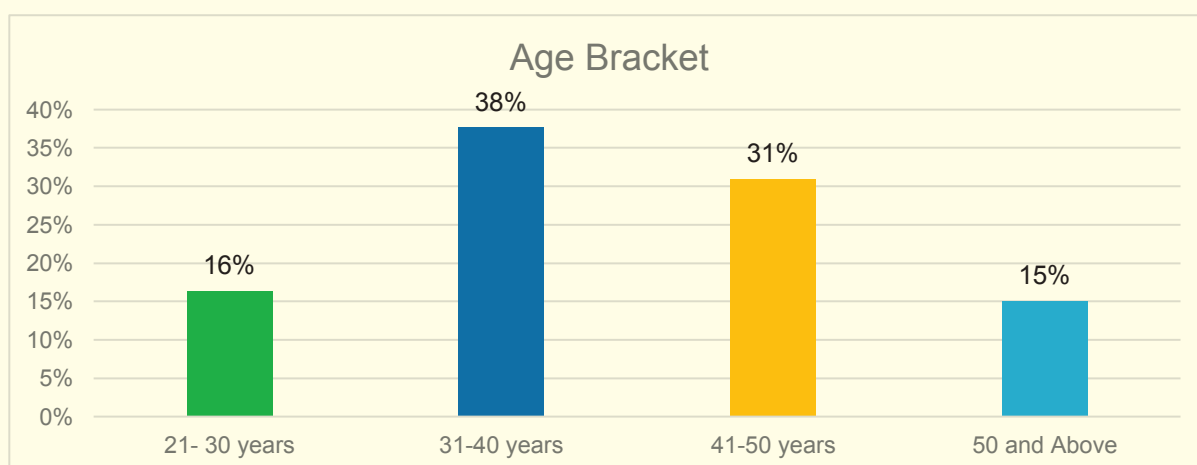


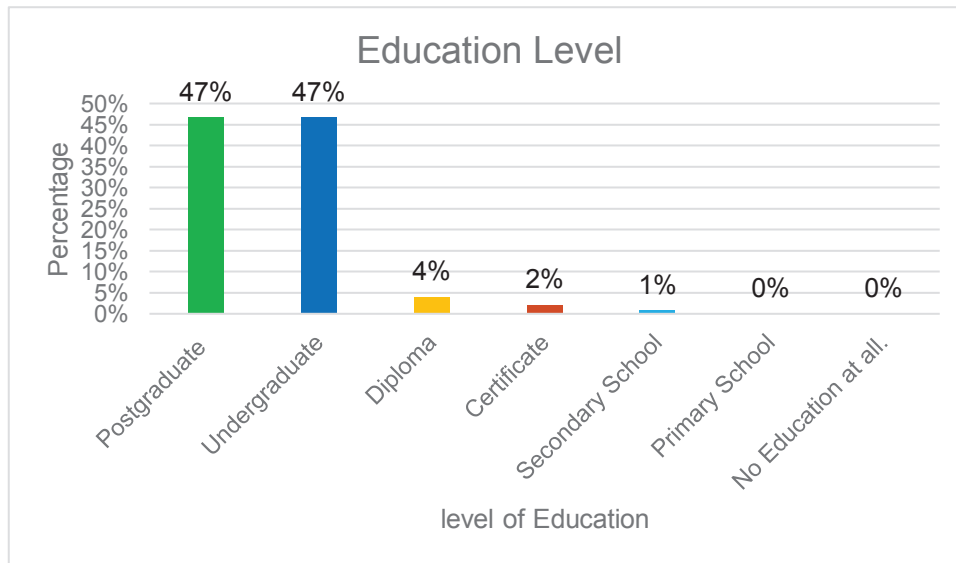
Figure 2: Average Age of User Respondents

As per Figure 2, the 31 to 40 years formed the majority of the users of financial statements in Kenya followed by the 41 – 50 years group. This conforms to the National Council for Population in Kenya report (2020) that the most active Kenyan population is between 31 to 50 years hence they are expected to have a higher interest in financial statements for investment purposes.

### Education Level of the respondents in the user's category

Further to the ascertainment of respondents' education level, it is perceived that education influences individuals' awareness and ability to read and understand. The following is a representation of the levels of education for the sampled respondents in this study.

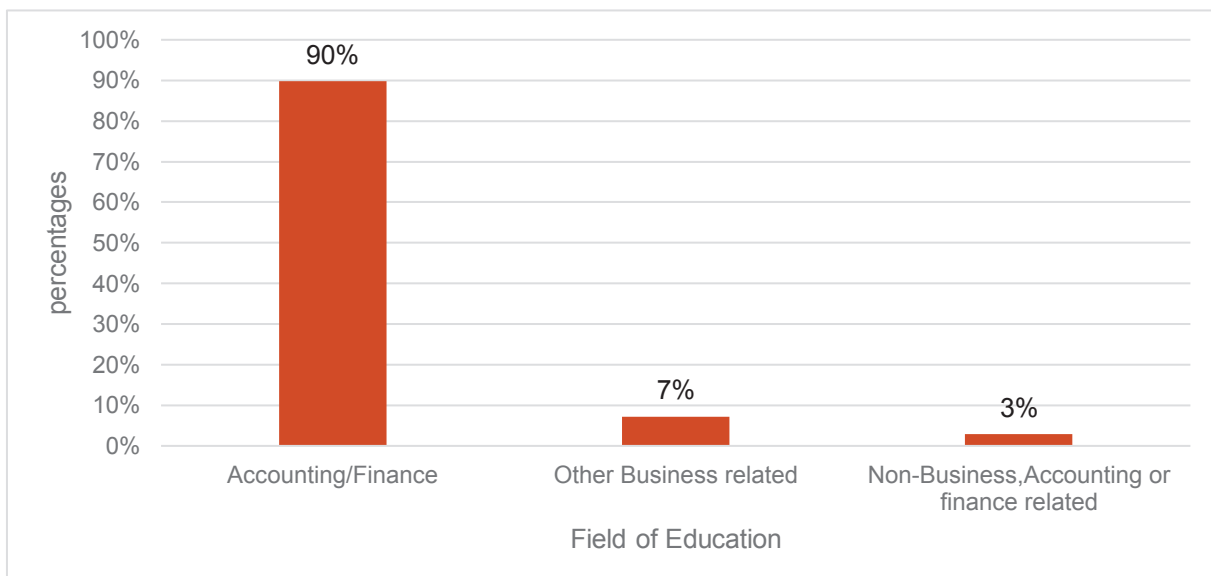




*Figure 3: Level of Education of User Respondents*

As per Figure 3, those who had postgraduate education were 47% and those that indicated undergraduate as their highest education level were also 47%. 4% of respondents had a diploma, 2% of respondents had a certificate and 1% had only secondary education. This indicates that respondents were literate and had the requisite exposure. However, having an education does not mean that one can understand financial statements (Wissing et al., 2016). Therefore, this calls for deliberate financial literacy training to equip users of financial statements with the requisite skill, knowledge, attitude, capacity and ability to interpret financial statements.

#### **Field of Education of the respondents in the users' category**



*Figure 4: Field of Education of User Respondents*

As per Figure 4, 90% of the respondents had a background in Accounting and Finance. This demonstrates a skewed pattern of response from those in accountancy-related backgrounds as opposed to other fields of education.

There is therefore need for sensitization to individuals from other professions to participate in surveys touching on financial statements because they affect every user regardless of their field of specialization.

**Respondents Physical Ability**

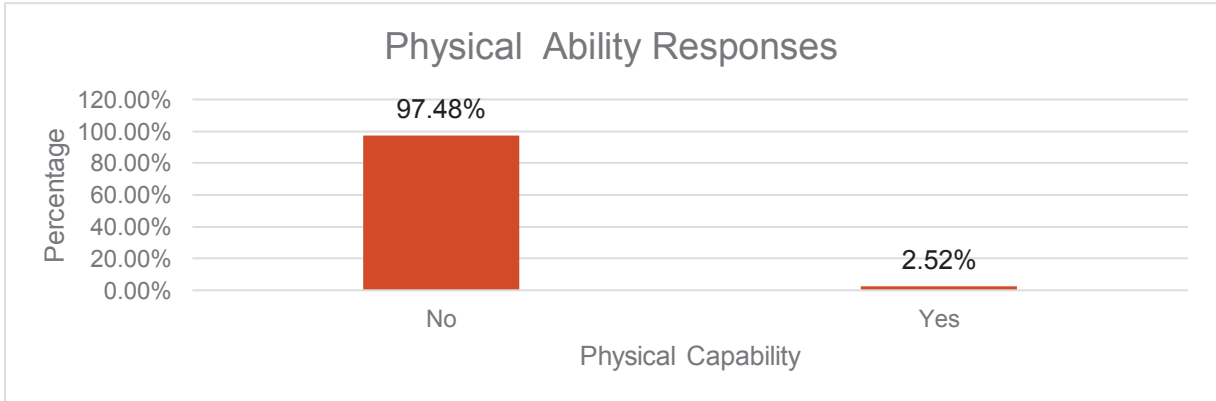


Figure 5: Physical Ability of Respondents

As per Figure 5, 97% of respondents indicated that they did not have any physical challenge while 3% were physically challenged. Out of the physically challenged, 29% had visual impairment, 14% had hearing problems and 57% had other physical challenges like mobility. Their contribution helped in determining whether there is a need for special consideration for persons living with disabilities while preparing the financial statements.

**The number of years that respondents have been reading financial statements**

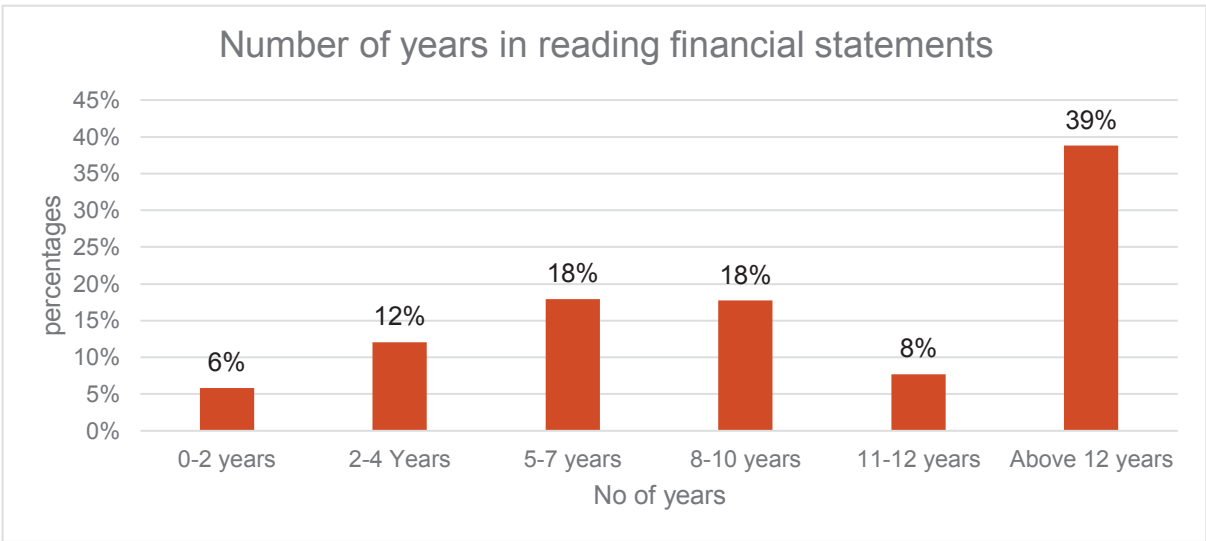


Figure 6: Number of years of reading financial statements by user respondents.



As per Figure 6, 6% of the respondents indicated that they have been reading financial statements for less than 2 years, 12% between 2-4 years, 18% between 5-7 years, 18% between 8-10 years, 8% between 11-12 years and 39% for more than 12 years. It is believed that the higher the number of years of interacting with financial statements, the higher the degree of readability and understandability (Kumar, 2014).

### Economic Sector of Interest to Respondents in the Users Category

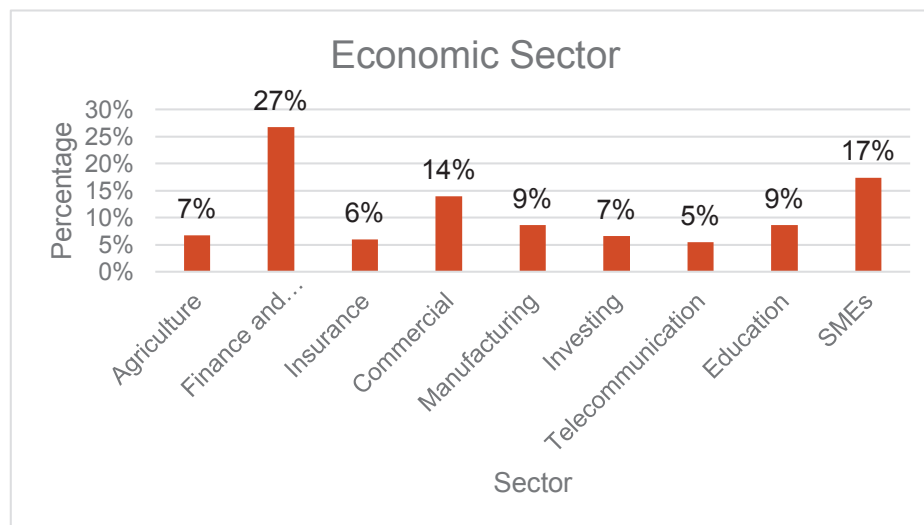


Figure 7: Economic Sector of Interest to User Respondents

As per Figure 7, 7% of the respondents read their financial statements in the agricultural sector, 27% in the finance and banking sector, 6% in the insurance sector, 14% in the commercial sector, 9% in the manufacturing sector, 7% in the investing sector, 5% in the telecommunication sector, 9% in the education sector, and 17% in the small and medium-sized businesses. This therefore means that majority of the financial statement users are more inclined to the finance and banking sector.





### Institutions that Respondents have Invested in, in the Users Category

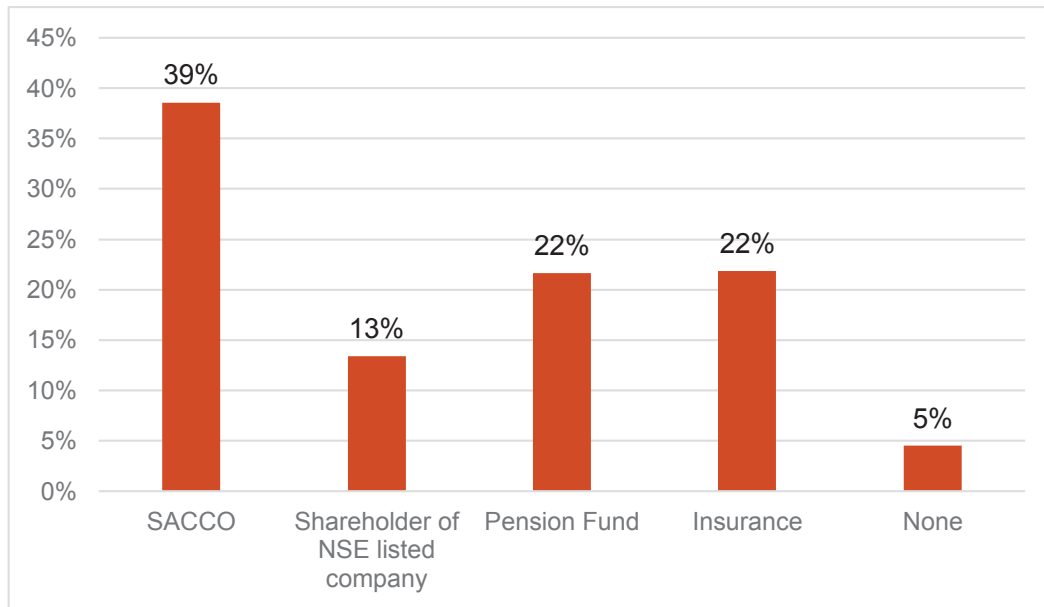


Figure 8: Institutions that the User Respondents have Invested in

As per Figure 8, 39% of the respondents had an interest in SACCO, 13% were shareholders of NSE listed companies, 22% were members of a Pension fund, 22% had insurance covers while 5% did not invest in any of these institutions. This links with Figure 7 where the majority of respondents were interested in finance and banking sector financial statements.

### Accessibility of Financial Statements by Respondents in the Users Category

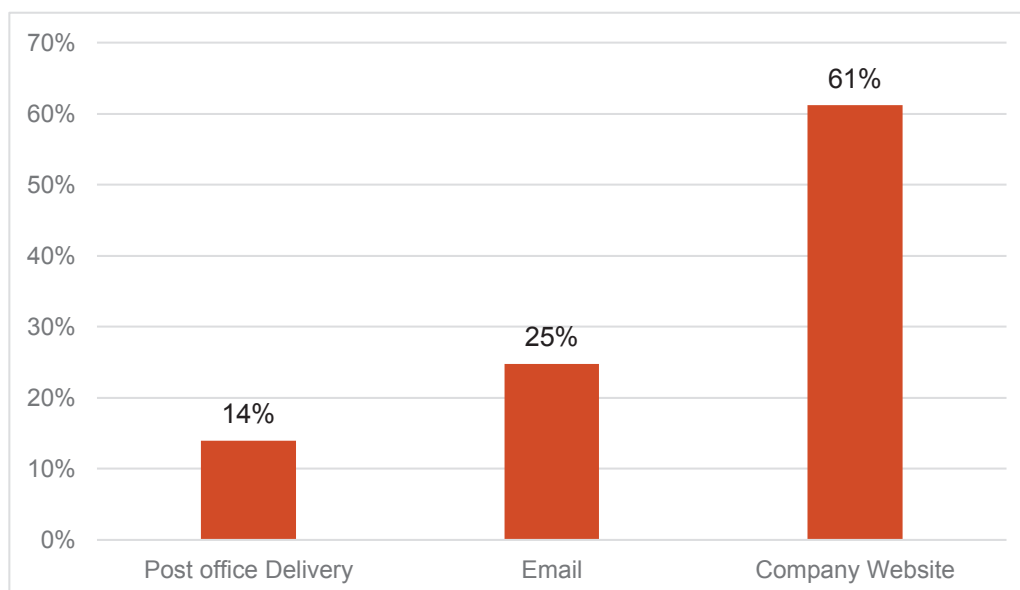


Figure 9: Accessibility of Financial Statements by User Respondents



As per Figure 9, 14% of the respondents access financial statements via post or hand delivery, 25% through email and 61% via the company's website. This conforms to the move of businesses towards embracing technology and the adoption of new technology. For ease of credibility and verifiability of financial statement information, there is a need to control and have visibility of the information contained on the websites. It is also observed that newspapers are among the avenues through which users access financial statement information.

### Extent of readability of financial statements by Respondents in the Users Category

The chart below represents the findings.

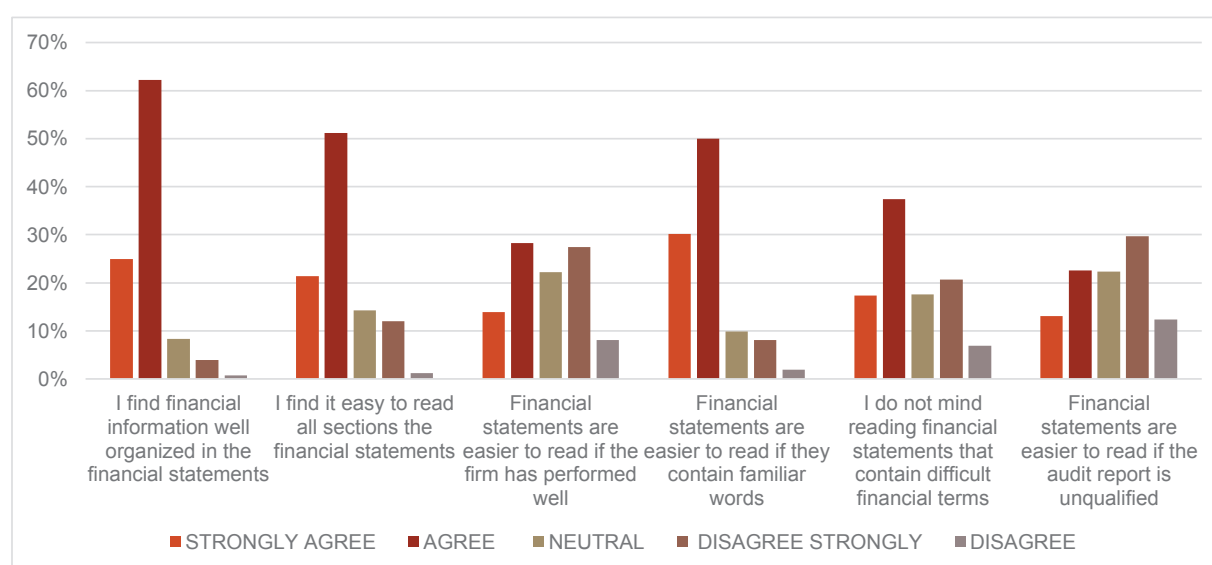


Figure 10: Extent of Readability of Financial Statements by User Respondents

As per Figure 10, 87% of the respondents indicated that they find financial information well organized in the financial statements. Further, 72% of the respondents find it easy to read all the sections of the financial statements. 54% of the respondents did not mind reading financial statements that contain difficult financial terms. These findings agree with Figure 4 and Figure 6 which indicated that a majority of the respondents had a background in accounting and finance and had interacted with financial statements for a period of above 12 years. This may not be true for those without a background in accounting or finance.

42% of the respondents find it easier to read if the firm has performed well while 27.46% indicated vice versa. The research found that 80% of the respondents found financial statements easier to read if they contain familiar words. These findings resonate with the theory of incomplete revelation and Zipf's law.

It was also found that 36% of the respondents regard financial statements easier to read if the audit report is unqualified while 42% of the respondents were not influenced by the type of audit report.



## The extent of Understandability of Financial Statements by Respondents in the Users Category

The chart below represents the findings.

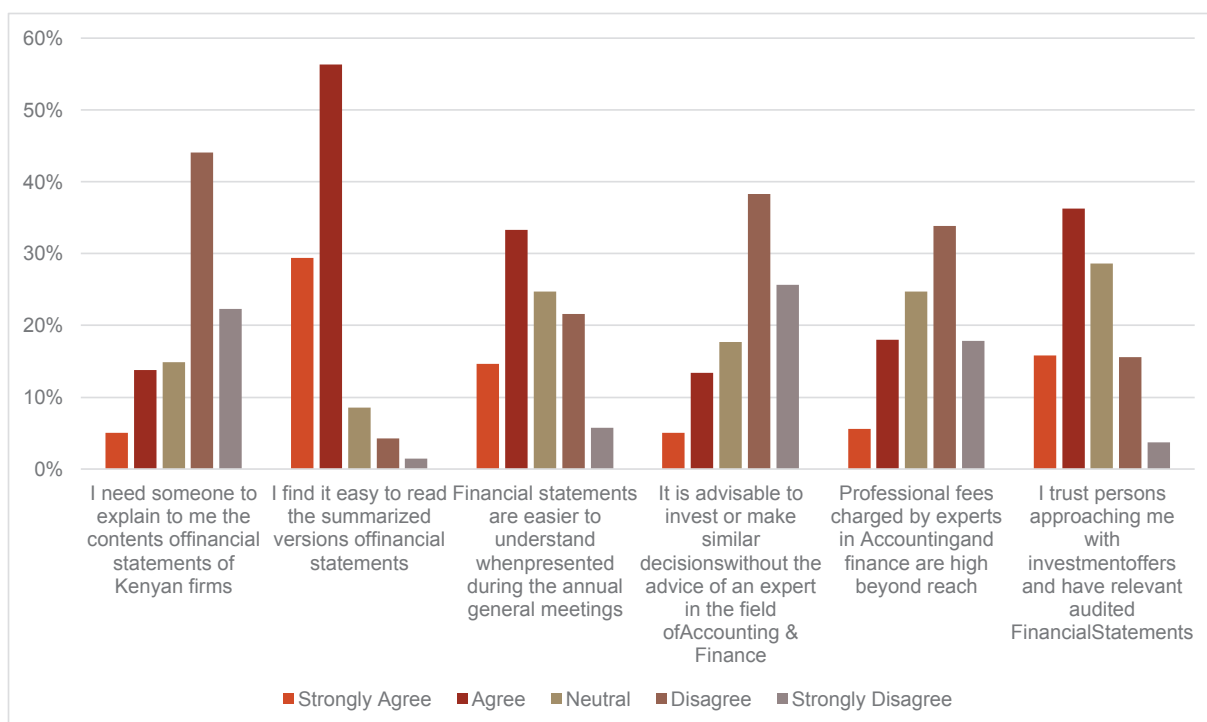


Figure 11: Extent of Understandability of Financial Statements by User Respondents

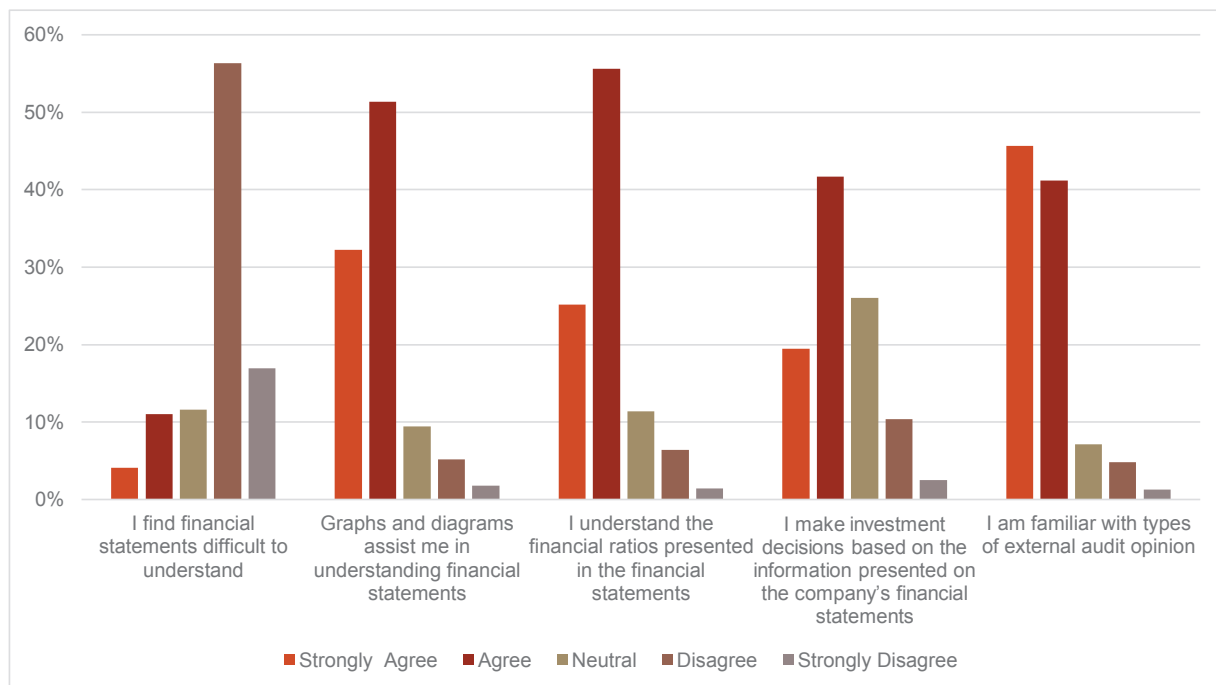
As per Figure 11, 66% of the respondents opined that they did not need assistance to understand financial statements. These findings agree with Figure 4 and Figure 6 which indicated that a majority of the respondents had a background in accounting and finance and had interacted with financial statements for a period of above 12 years. This may not be true for those without a background in accounting or finance.

The study established that 85% of the respondents agreed that they understood the financial statements much better when they are summarized. 48% agreed that the presentation of financial statements at the Annual General meetings made financial statements more understandable while 28% of the respondents indicated the contrary. At the AGM the financial statements are explained and questions relating to the statements are responded to.

The findings indicated that 64% of the respondents agreed that they needed professional guidance when making investment decisions. This finding indicates that ability to read and understand financial statements may be different from the ability to make sound investment decisions.

The study also found that 52% of respondents trusted audited financial statements. This may be because audited financial statements provide a high level of assurance of the truthfulness and fairness of the financial statements. It was found that 24% of the total respondents believed professional fees charged by Accounting and finance experts as being high while 52% were okay with the fees charged by the experts.

**The Extent to which Readers / Users understood the Contents of Financial Statements**  
The chart below represents the findings.



*Figure 12: The Extent to which Users understood the Contents of Financial Statements*

As per Figure 12, 73% of the respondents found it easy to read the summarized versions of financial statements. 83% of the respondents indicated that graphs and diagrams assisted them in understanding financial statements. 81% of the respondents understood the financial ratios presented in the financial statements. 61% of the respondents made investment decisions based on the information presented on the company’s financial statements. 87% of the respondents were familiar with types of external audit reports while 4% were not.

These findings corroborate Figure 4 and Figure 6 which indicated that a majority of the respondents had a background in accounting and finance and had interacted with financial statements for a period of above 12 years. This may not be true for those without a background in accounting or finance.

## User prior training on reading and understanding financial statements

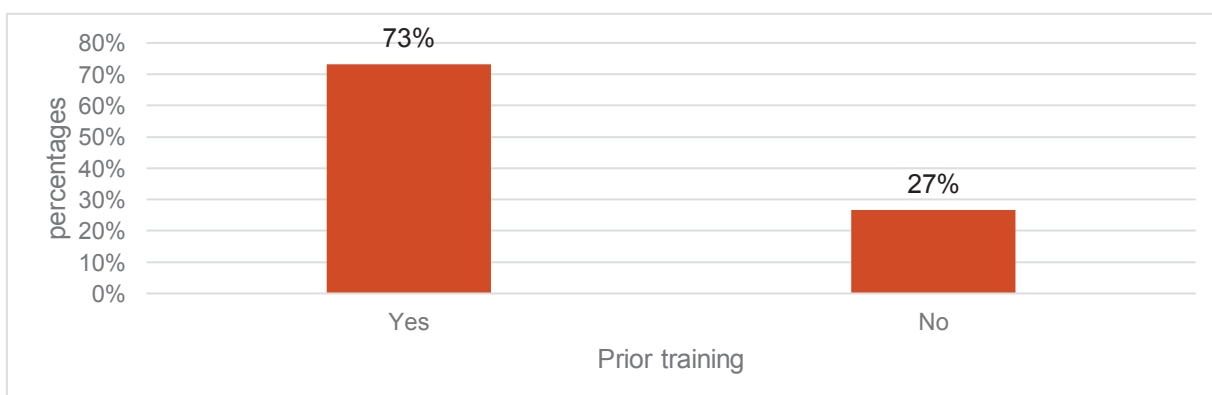


Figure 13: User prior training on reading and understanding financial statements.

As per Figure 13, 73% of the respondents agreed to have had training prior to reading and understanding financial statements whereas 27% did not have prior training on financial statements.

### Summary of Findings and Conclusion

- From the survey, majority of the users of financial statements were men, implying that more men are likely to be in charge of financial decision-making as compared to their female counterparts.
- The most active users of financial statements are aged 31-50 years. This conforms with the National Population Council of Kenya report of 2020 that categorizes this group as the most active population in the Kenyan economy.
- Majority of the respondents had at least an undergraduate degree qualification, implying that the respondents were well educated.
- A good number of the respondents had a professional background in Finance, Accounting, and Business - related background. This indicates that most respondents within the user group were concentrated in Finance Accounting and Business-related fields.
- The Banking and Finance sector had the highest percentage of financial statement user respondents whereas the telecommunication sector had the least users. It can therefore be concluded that the banking and finance sectors have their financial statements easily accessible to the users. Similarly, this could also mean that most users are inclined to financial statements from the Banking and Finance sector.



- f) From the study among the sampled institutions where respondents had invested their interests, SACCOs had the highest percentage followed by Insurance.
- g) More than 80% of the respondents accessed financial statements via email or by downloading directly from the company's website while around 15% received financial statements via postal services. This shows that more companies are adopting digital platforms as means to communicate to their users.
- h) More than 50% of the respondents had an adequate understanding of financial statements and at least 41% of the respondents relied on the information presented to make informed economic decisions.
- i) The study registered responses from people living with a disability indicating that they also utilize financial statements. Out of those who responded with disability; 29% had visual impairment, 14% had hearing problems while 57% had other forms of disability.

### **Respondents' view on outline, content, or presentation format of Financial Statements**

Respondents outlined challenges they had experienced with the outline, content, or presentation format of financial statements in Kenya. These included:

Difficulty in accessing the financial statements – Section 670 of the Companies Act, makes it mandatory for the quoted companies, in addition to submission, to post their annual financial statements and directors' reports on the companies' websites. The financial statements shall remain posted until the next reports are published and posted. However, to the study, some companies do not post financial statements on their website making it hard for users to make investment decisions.

- a) Complexity and ambiguity in the language used in the preparation of financial statements. The study revealed that the language used in the financial reports is one of the challenging areas for the users. These include the accounting standards and regulatory frameworks, abbreviations and acronyms and terms of reference.
- b) Language barrier – from the study financial statements are prepared in English language only, which is incomprehensible to some users.
- c) Some respondents believed that financial statements present too much detail.
- d) Some respondents believed that there was inconsistent financial statement presentation hence compromising on intercompany comparisons.
- e) Some respondents believed that some financial statements contained summarized figures without notes and some companies do not provide reference notes on their financial statements making it hard for readers to understand.
- f) Some respondents have challenges verifying information posted on the company websites. Hence the need for laws regulating the posting of audited financial statements on the websites.
- g) Some companies delay in posting financial statements on their websites and hence users cannot get the information needed in good time to make informed decisions.
- h) Some users especially from rural and remote areas with internet connectivity challenges are unable to access financial statements from company websites.



## RECOMMENDATIONS

**Table 3: Recommendations from User Findings**

	Recommendation	Rationale	Responsibility
1.	The financial statements should be reported in both English and Kiswahili as the two official languages in Kenya.	For ease of readability and understandability of financial statements in a more convenient way.	Preparers Regulators
2.	Publish financial statements on the entity's website without undue delay.	For easy access to financial statement information in a promptly.	Entities' Preparers of financial statements
3.	Provide explanatory notes as annexes to accompany financial statements	To present financial statements concisely and minimize the use of jargon in the statements	Preparers
4.	Present at least two sets of financial statements; a simplified set and a detailed set of financial statements	To enhance the users' readability and understandability especially those without an accounting and finance background	Preparers
5.	Enhance visualization in the presentation of financial statements. For instance, adopt the use of graphs, images and charts. In addition, provide a comparison of at least two financial years	To enhance the users' readability and understandability.	Preparers
6.	Financial statements should have embedded notes which should be precise and contain explanations of the accounting policies adopted by an entity	For efficiency and effectiveness in the reading and interpretation of financial statements by the users some of whom could be having minimal accounting and finance knowledge	Preparers
7.	Conduct training and workshops and facilitate programs that create awareness among the various users of financial statements. Training should be anchored in ancillary professions such as auditing.	To promote objectivity and independence of the various users within the realm of auditing practice	Regulators (ICPAK, PSASB)
8.	Communicate effectively the changes in the reporting standards and templates to be adopted by users and preparers	To enhance compliance, readability and understandability of financial statements among the users and preparers	Regulators (ICPAK, PSASB)

	<b>Recommendation</b>	<b>Rationale</b>	<b>Responsibility</b>
9.	Entities should publish and publicize financial statements in different media channels i.e websites.	To broaden the scope of coverage and reach the preparers and users	Preparers
10.	Encourage entities registered under the Companies Act to prepare financial statements.	To enhance access to credit, fair tax assessments and comparability.	Regulators
11.	Ensure accessibility of financial statements in formats that can be consumed by people abled differently especially those with visual impairment	To accommodate all users of financial statements irrespective of their physical conditions	Regulators Preparers
12.	Put measures in place to guarantee credibility, verifiability, truthfulness and fairness of financial statements	To aid in making proper investment decisions	Regulators Preparers
13.	The company website should contain at least the latest seven years of intra-company comparison of financial statements	For completeness and verifiability of financial statements by the users	Regulators
14.	Incorporate financial literacy units in the school curriculum at the early stages of learning.	For gradual acquisition of financial literacy and enhanced proficiency among learners as would-be users of financial statements.	Kenya Institute of Curriculum Development Regulators



## CHAPTER III:

# Preparers of Financial Statements



## Introduction

This subsection seeks to answer the research question: what interventions do preparers of financial statements provide in the reading and understanding of financial statements by users in Kenya? The subsection contain the profile of financial statement preparers in Kenya, the extent to which users seek the services of preparers of financial statements, the efficiency and effectiveness of printing and posting financial statements, the mode of communicating financial statements to the users and the challenges faced by the preparers of financial statements in Kenya and the recommendations.

The preparation of financial statements involves the process of consolidating accounting information into a standardized set of financials. The International Accounting Standard 1 (IAS) provides a framework for the preparation and the presentation of financial statements. This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability of both the entity's financial statements of previous periods and the financial statements of other entities.

IAS 1 sets out the requirements for financial statements, including how they should be structured, the minimum requirements for their content and key concepts such as going concern and the accrual basis of accounting. The standard requires a complete set of financial statements to comprise a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity and a statement of cash flows.

It is important to note that the overall objective of general-purpose financial statements is to provide critical information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users and readers in making sound economic decisions.

### The profile of preparers of financial statements in Kenya

#### Demographics

The study provides essential demographics on respondents such as level of education and gender as provided below:

#### Gender

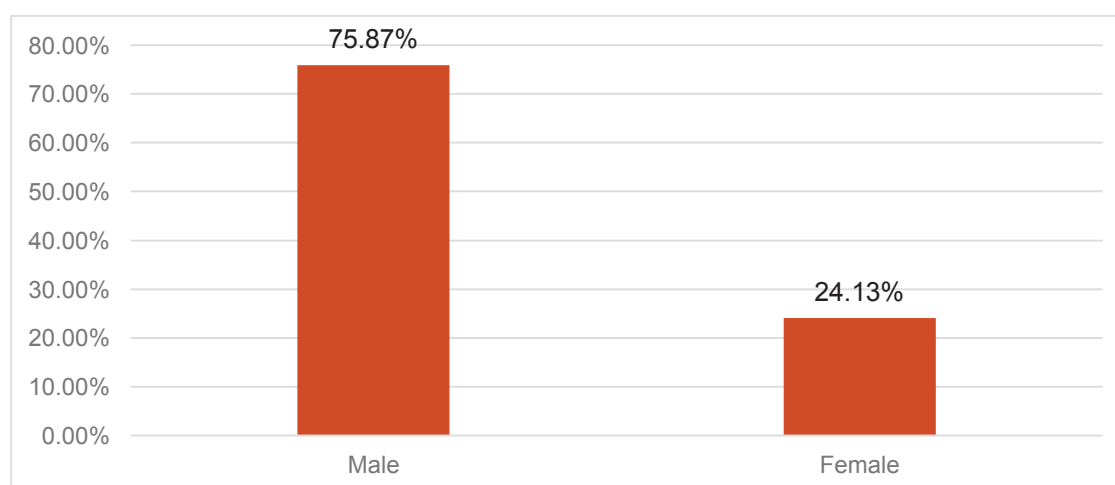


Figure 14: Gender Representation amongst Preparer Respondents



In terms of gender spread amongst preparers, 76% were male while 24% were female. This indicates the issues of disparity in the uptake of finance and accountancy positions in Kenya. Perhaps the gender disparity can be addressed at the secondary school level where girls can be encouraged to consider taking up accounting and finance as a future career.

### Disability

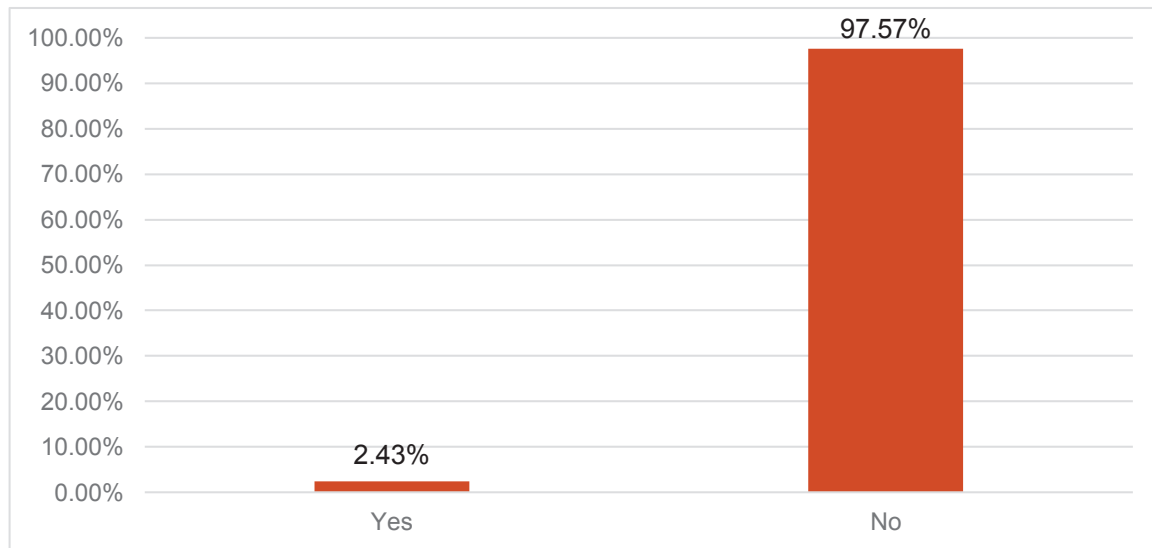


Figure 15: Physical Ability of Preparer Respondents

98% of the respondents did not have disabilities while 2% were persons living with disabilities.

### Types of Disability

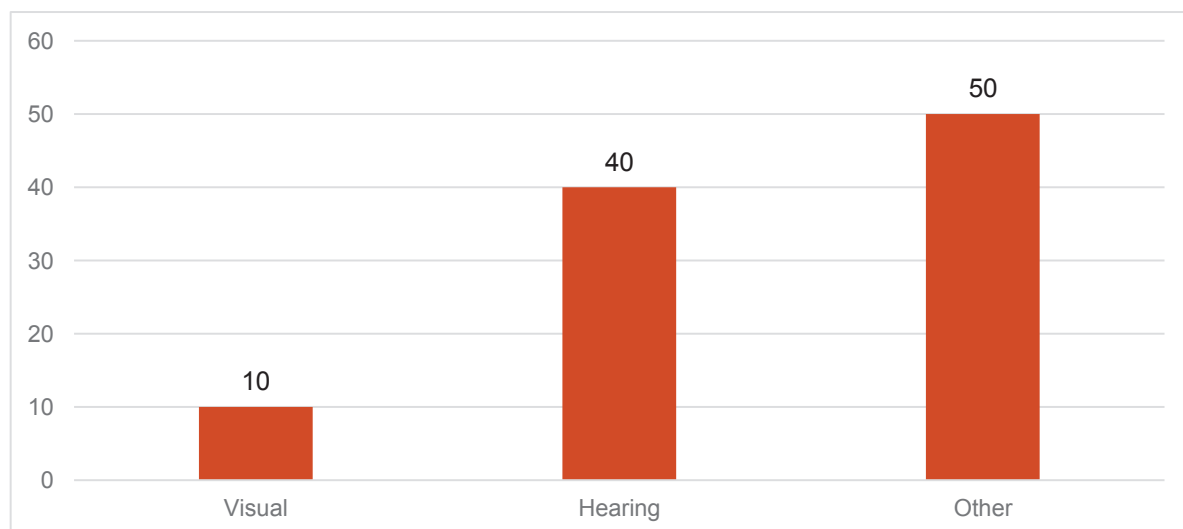


Figure 16: Types of Disability of Preparer Respondents



Of the 2% living with disabilities, 10% had visual impairment, 40% had a hearing impairment and 50% had other physical disabilities like mobility. There is a need to create a conducive working environment for the People living with Disabilities like investing in equipment that is user-friendly in the accounting and finance sector and liaison between ICPAK and relevant bodies dealing with persons abled differently e.g. the National Council for Persons Living with Disabilities and Kenya Institute for the Blind to invest in user-friendly equipment.

### Field of Education

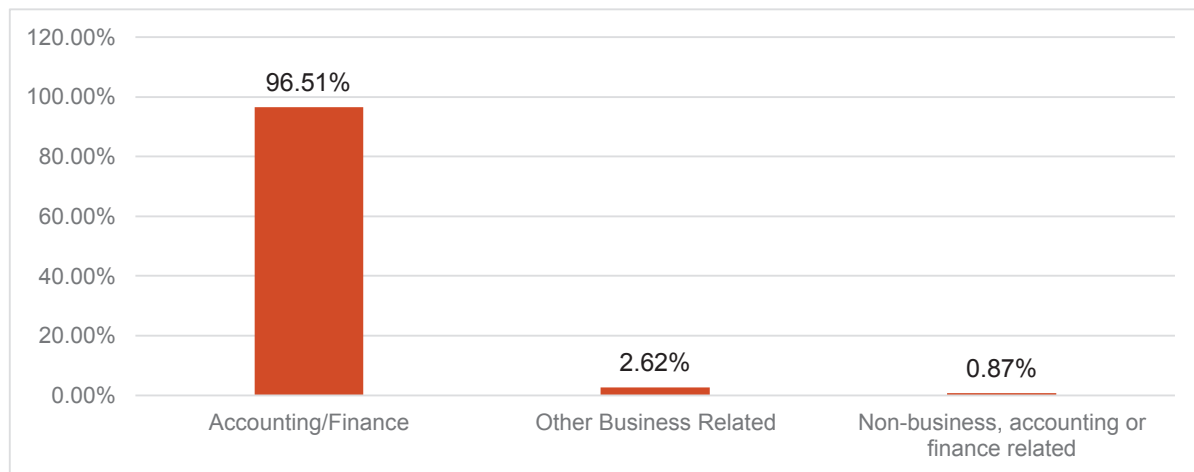


Figure 17: Field of Education of Preparer Respondents

From the study, 97% of the respondents indicated having expertise and education background in the area of finance while 2% had business-related training with only 1% with non-business accounting or finance. This should be consistent with the fact that the preparation of financial statements is solely a preserve of Certified Public Accountants who have the know-how and understanding of the requirements and accounting standards used in the completion of the task.

## Level of Training

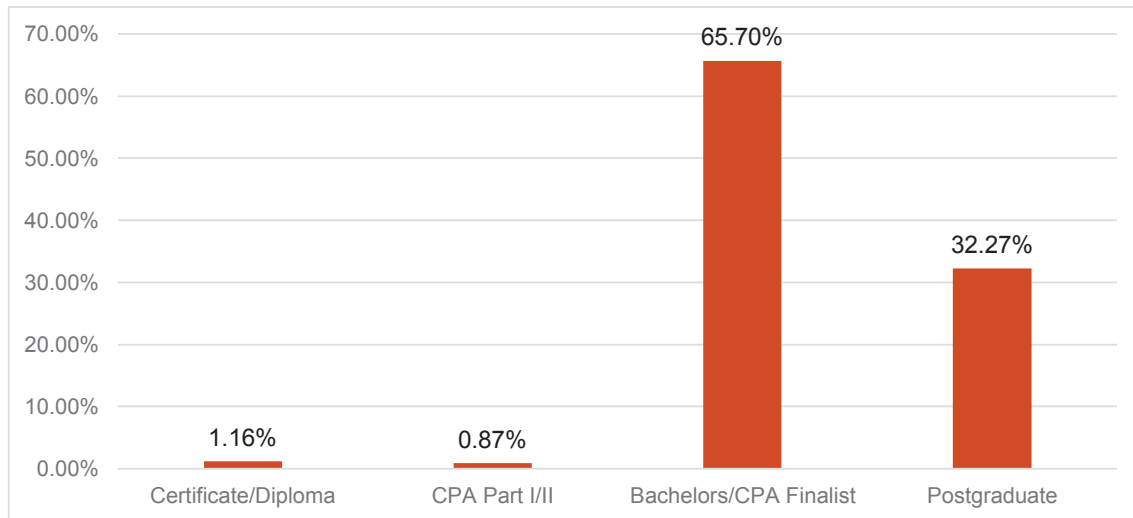


Figure 18: Level of Training of Preparer Respondents

The study further interrogated the level of training and noted that 66% of the respondents had acquired a bachelor's degree and a CPA professional certification. 32% had a postgraduate qualification, with 1% with CPA Part I/II and another 1% with certificate/diploma qualification. This indicates that there are a few non-qualified accountants who are currently preparing financial statements. Unauthorized preparers of financial

## Sectors

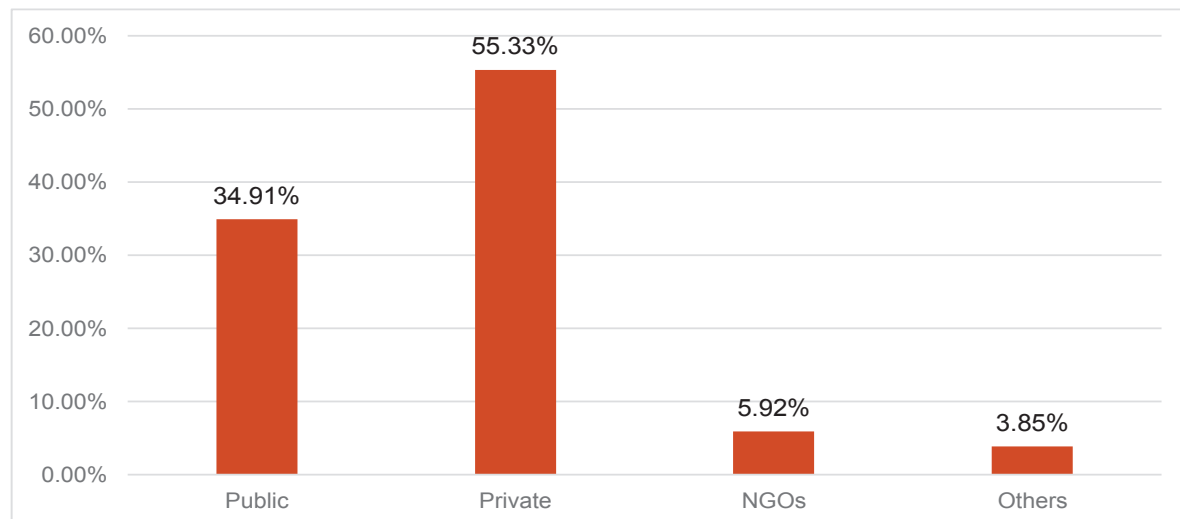


Figure 19: Sectoral Distribution of Preparer Respondents



On sector based distribution of preparers, the majority of the respondents, 55% were from the private sector with the public sector, NGO and other sectors at 35%, 6% and 4% respectively. This is a reflection of the spread of the ICPAK membership across the sectors. “Others” included respondents from schools, churches, special vehicle entities like mutual funds.

### Public Sector Categorization

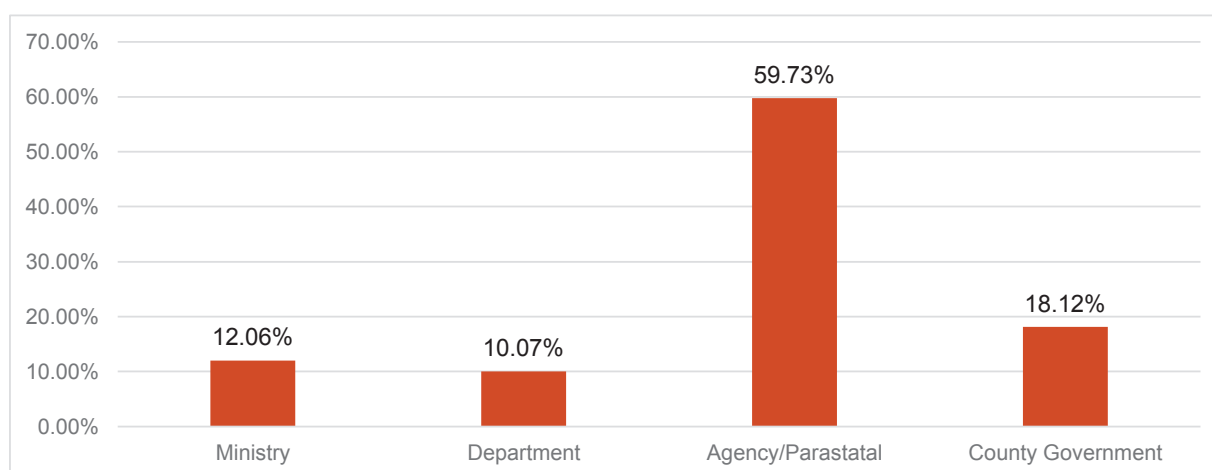


Figure 20: Public Sector Categorization of Preparer Respondents

Further categorization of the public sector indicated that the majority of the respondents, 60% were drawn from the parastatals, with County Governments, Ministries and Departments accounting for 18%, 12% and 10% respectively.

### Sectoral Categorization

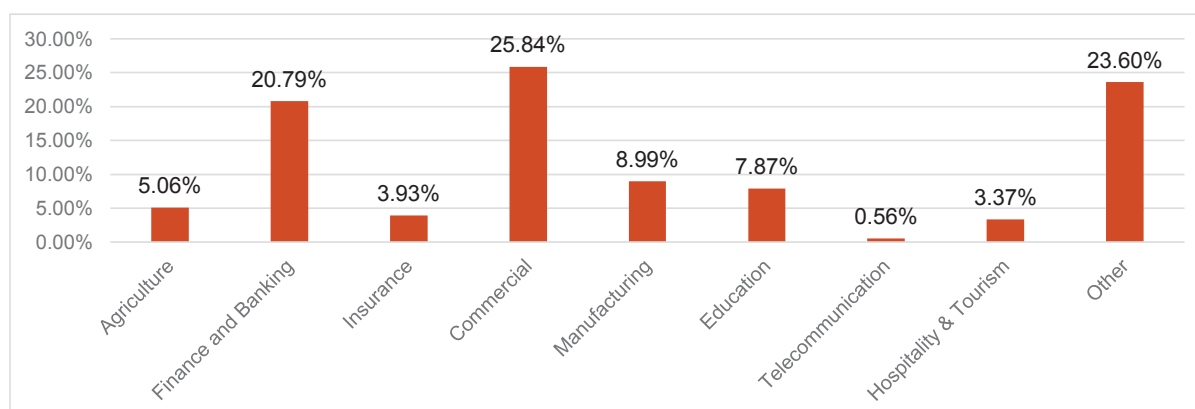


Figure 21: Sectoral Categorization of Preparer Respondents



Further disaggregation of the sectors had majority preparers from Commercial Sector at 26% and Banking Sector at 21%. The study obtained feedback from Education, Manufacturing, Insurance, Telecommunications, Hospitality and Agriculture sectors.

### Size of the Company

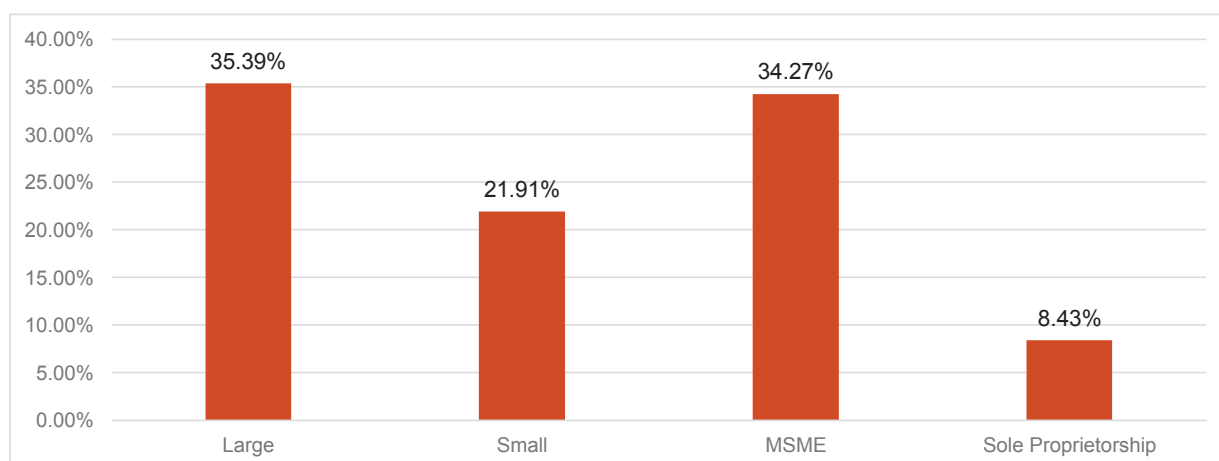


Figure 22: Size of the Company Represented by Preparer Respondents

The study obtained demographics on the size of the firm or company, with the participation of 35% from large companies, while small, MSME and sole proprietorship accounted for 22%, 34% and 8% respectively. Additional attention should be given to MSMEs as key enablers of economic growth and development in Kenya and other parts of the world.

### ICPAK Membership

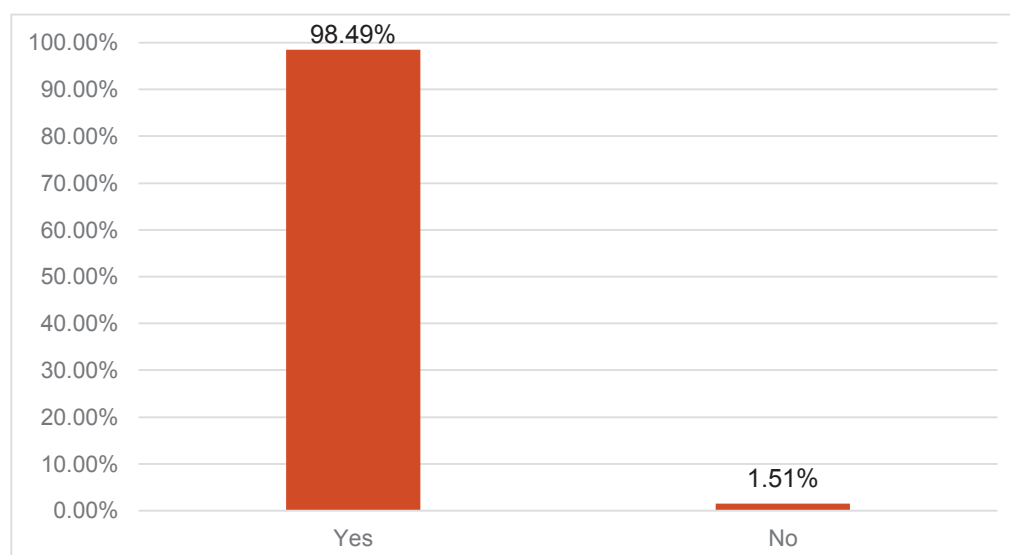


Figure 23: ICPAK Membership of Preparer Respondents



The study found that 98% of the respondents were members of the Institute with 2% being non-members. The Institute has been at the forefront in ensuring that only regulated professionals are tasked with the preparation of financial statements and the performance of accountancy responsibility. The non-members should be encouraged to become members of the Institute.

### ICPAK Member Category

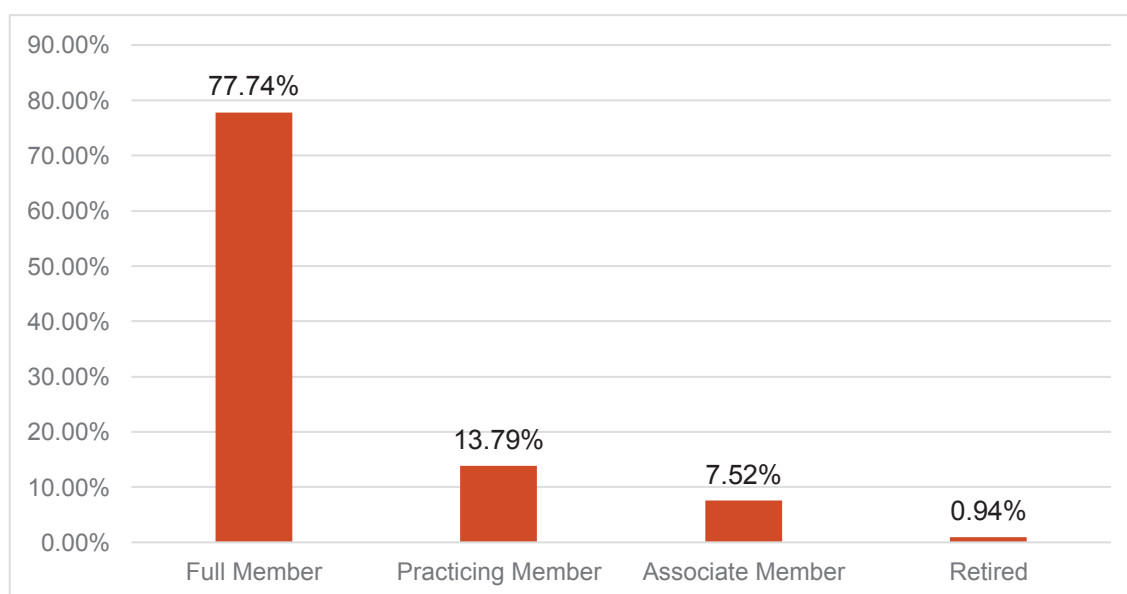


Figure 24: ICPAK Member Category of Preparer Respondents

The study further sought to obtain disaggregated data on member categorization in the preparation of financial statements. 77% were full members, 14% practicing members with associate and retired members at 8% and 1% respectively.



## The extent to which users seek the services of professionals to be assisted in understanding financial statements

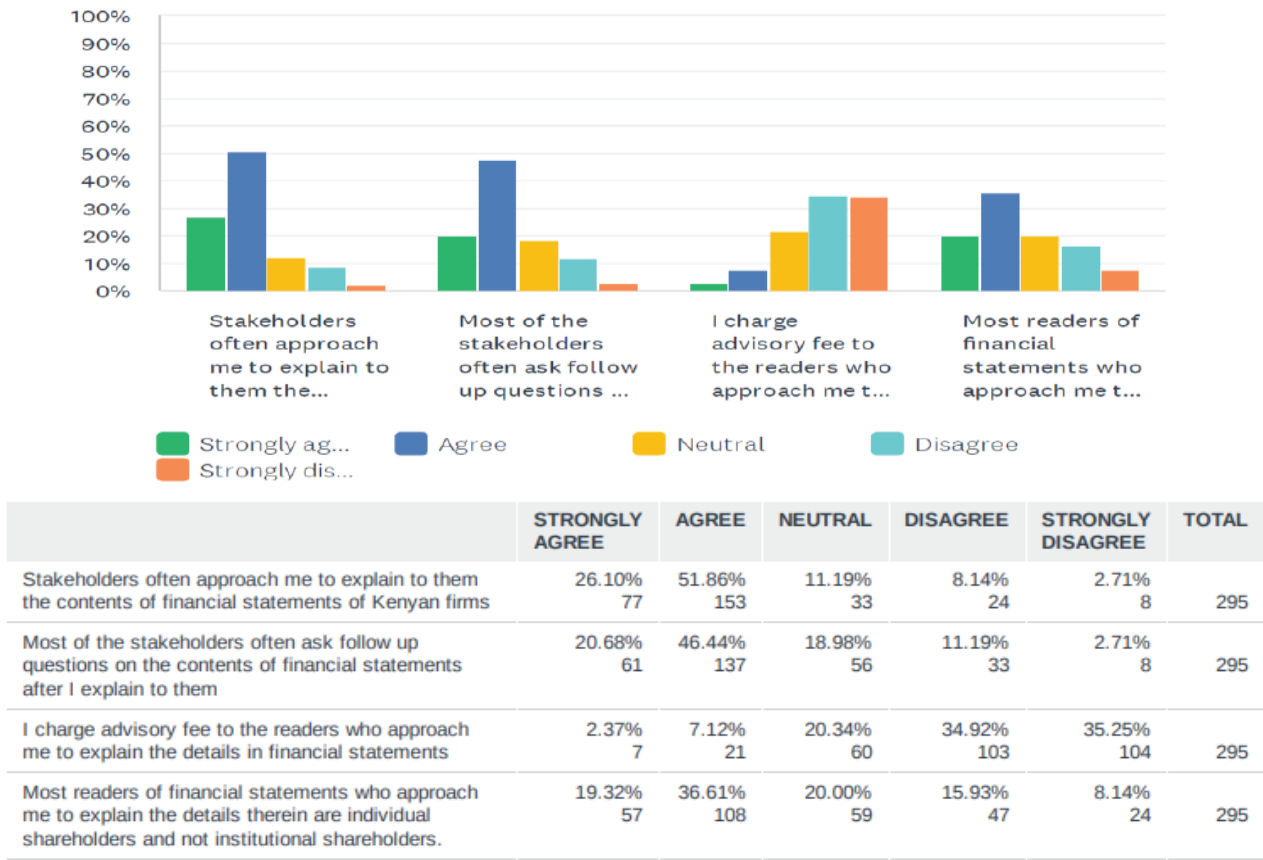
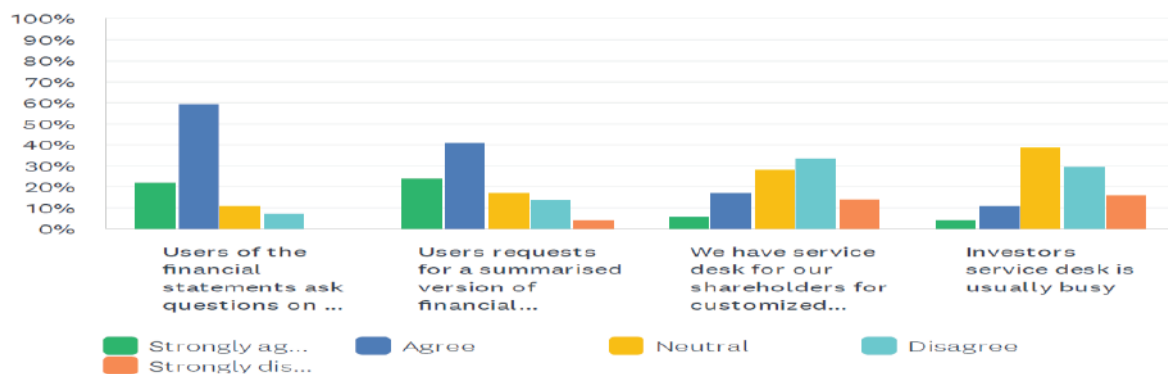


Figure 25: Extent to which users seek the services of professionals to be assisted in understanding financial statements (a)

The study found that 78% of the respondents had been approached by stakeholders to explain the contents of financial statements. Further, 67% of the respondents indicated that stakeholders asked follow-up questions.

These findings show that there is low understandability of financial statements amongst stakeholders. The study also found that 70% of respondents indicated that they do not charge advisory fees to readers who approach them to explain financial statements. These findings show that there is a willingness amongst preparers to facilitate the understandability of financial statements among users. In addition, the study found that 56% of the stakeholders who approach the preparers are individual stakeholders rather than institutional stakeholders.

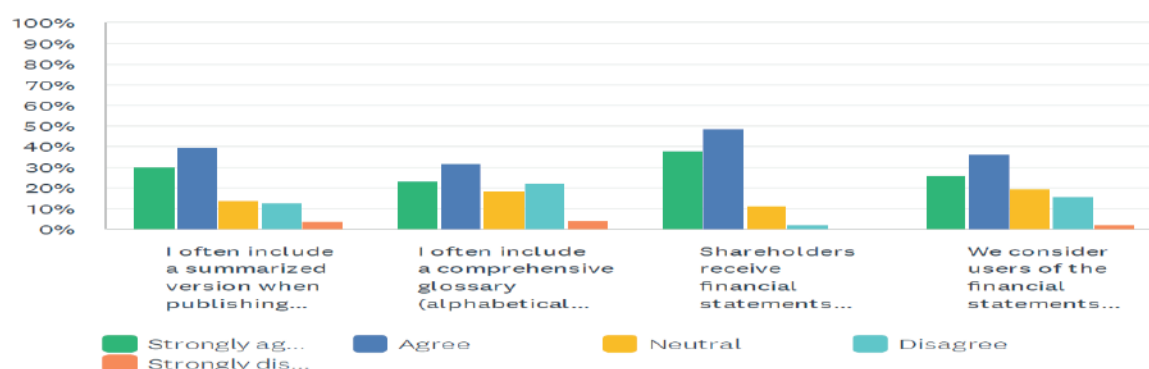


	STRONGLY AGREE	AGREE	NEUTRAL	DISAGREE	STRONGLY DISAGREE	TOTAL
Users of the financial statements ask questions on the matters to do with financial statement.	22.73% 60	59.09% 156	10.61% 28	7.20% 19	0.38% 1	264
Users requests for a summarised version of financial statements.	25.00% 66	40.53% 107	16.67% 44	14.02% 37	3.79% 10	264
We have service desk for our shareholders for customized financial explanation on financial statements. (Investor based financial services)	5.68% 15	16.67% 44	28.79% 76	34.09% 90	14.77% 39	264
Investors service desk is usually busy	4.17% 11	11.36% 30	37.88% 100	30.30% 80	16.29% 43	264

Figure 26: Extent to which users seek the services of professionals to be assisted in understanding financial statements (b)

From the study, 81% of users ask questions on matters to do with financial statements and 65% requested for a summarized version of financial statements. The study also found that 21% of preparers had established a service desk for their stakeholders to provide a customized financial explanation on their financial statements preparers should be encouraged to offer more assistance to users in reading and understanding financial statements.

#### Effectiveness and efficiency of publishing of financial statements in Kenya



	STRONGLY AGREE	AGREE	NEUTRAL	DISAGREE	STRONGLY DISAGREE	TOTAL
I often include a summarized version when publishing financial statements.	30.40% 83	38.83% 106	13.92% 38	12.82% 35	4.03% 11	273
I often include a comprehensive glossary (alphabetical list of terms with definitions) in financial statements.	22.71% 62	31.87% 87	19.05% 52	21.98% 60	4.40% 12	273
Shareholders receive financial statements within the stipulated time.	38.10% 104	49.08% 134	10.62% 29	1.83% 5	0.37% 1	273
We consider users of the financial statements diverse level of education.	25.27% 69	36.63% 100	19.78% 54	16.12% 44	2.20% 6	273

Figure 27: Effectiveness and efficiency of publishing of financial statements in Kenya

The study found that 69% of preparers include a summarized version when publishing financial statements; 54% of preparers include a comprehensive glossary in the financial statements; 87% indicated sharing of financial statements with their shareholders within the stipulated time and 61% of preparers consider users' level of education when preparing financial statements. Whilst the majority of the preparers are accommodative of the varying needs of users when preparing financial statements, efforts should be made to encourage wholesome sharing on a timely basis of summarized financial statements with a comprehensive glossary.

### Mode of sharing and access to financial statements.

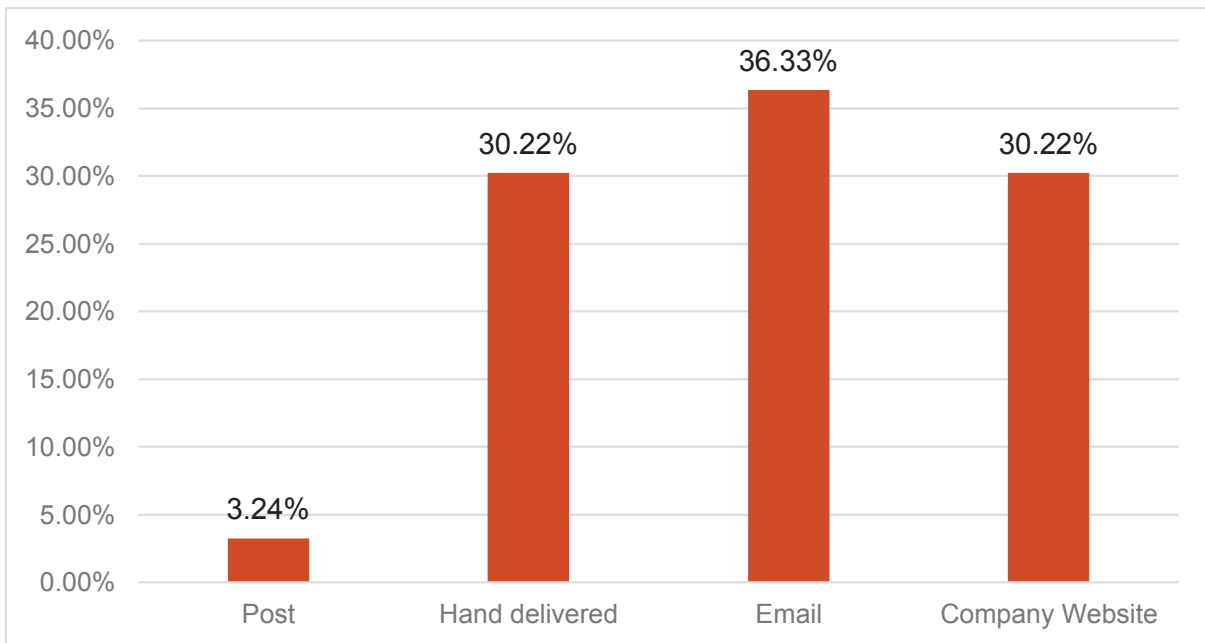
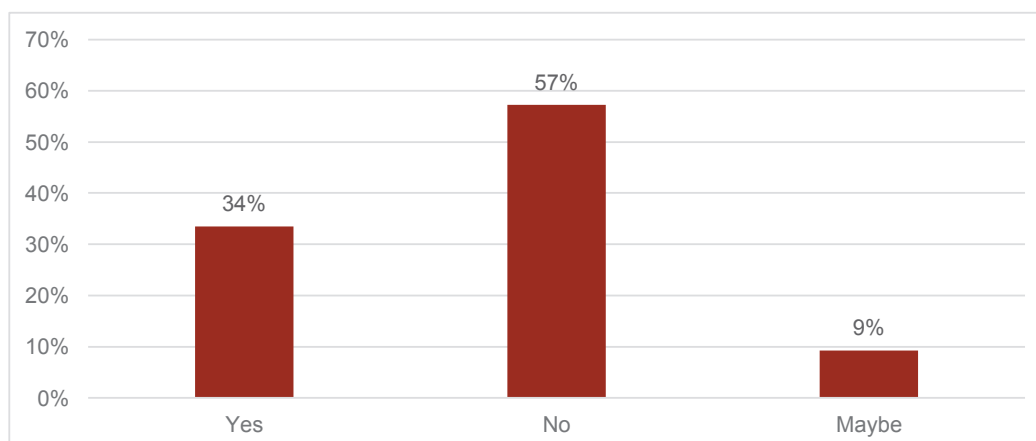


Figure 28: Mode of sharing and access to financial statements

It was found that 36% of preparers share financial statements via email, 30% upload on the company website, 31% hand deliver and 3% send via post. This is an indicator that companies are embracing technology in publishing and publicizing financial statements. Others have developed mobile and web-based applications to share financial statements and enhance readership amongst the users. Notwithstanding, there are some users that do not have access to emails or company websites and require financial statements. Companies are therefore encouraged to provide hard copies to these special groups as well as availing them in formats suitable for persons abled differently.

Whilst listed companies and those with public interest are obligated to publish financial statements, this is not the case for private companies. There were concerns on whether the corporates have working websites and whether the financial statements are updated regularly on those websites. There were also concerns on whether the information on the companies' websites is identical to the audited printed versions of financial statements.

## Printing and Posting Financial Statements.



*Figure 29: Printing and Posting Financial Statements*

It was found that 57% of preparers do not support printing and posting financial statements to shareholders given the availability of alternative communication technology. They raised different reasons including cost-saving, environmental conservation and accessibility. It is noteworthy that the Covid-19 pandemic enhanced the virtual communication of financial statements.



## CHALLENGES AND RECOMMENDATIONS

The following are the challenges and recommendations highlighted by the preparers.

Table 4: Challenges Highlighted by Preparers and Recommendations Based on their Findings

	Thematic Area	Challenges	Recommendations	Responsibility
<b>Legal and Regulatory</b>				
1.	Standards and Reporting Templates	Lack of a standardized reporting template for different sectors	Provide standard reporting templates within sectors.  Widespread public participation when developing new templates.	ICPAK, PSASB
		Frequent changes in accounting standards affect comparability and compliance	Frequent training sessions for preparers	ICPAK, IFAC
		The late release of formats for reporting	Timely release of reporting templates	ICPAK, PSASB
		Summarization of accounting information and still comply with accounting standards	For public sector financial statements preparation, there is a need to provide a standard template for the summarized versions of financial statements.	PSASB
		Formats for the presentation of financial statements generalized and not specific to individual entities hence compromising understandability	Provide industry-specific financial reporting templates	PSASB, ICPAK
		The PSASB templates keep changing and short notice is given for the sensitization/training.	Continuous training on the templates. Increase the notice period for training on new standards.	PSASB
		The templates do not fully comply with IPSAS	Continuous training on the templates and the emergent changes thereof.	PSASB, ICPAK
		Too many details for less complex entities such as MSMEs	Adopt IFRS for MSMEs which has fewer requirements.	Preparers
		Different classification of expenses in different counties mostly treatment of Road Levy Fund and other grants	Standardize modules of accounting and financial systems such as IFMIS and other ERP modules to enhance comparability.	National Treasury

	Thematic Area	Challenges	Recommendations	Responsibility
		Inadequate stakeholder consultation in the development of financial reporting templates	Widespread stakeholder consultation and engagement.	ICPAK, PSASB, CBK, SASRA, CMA and other regulators
2.	Legal Environment	Unaligned statutory requirements e.g different requirements for timelines by different regulators.	Harmonize and align statutory requirements	National Treasury, Parliament, OAG, ICPAK, PSASB, CBK, SASRA, CMA and other regulators
		Frequent changes in laws related to the preparation of financial statements e.g Finance Act	Expedite the adoption of the National Tax Policy as a framework for predictability.  Widespread stakeholder consultation in enactment of relevant laws.	National Treasury, KRA, Parliament, OAG, ICPAK, PSASB, CBK, SASRA, CMA
3.	Compliance	Unaligned frameworks guiding regulation and compliance in financial reporting	Harmonize frameworks for purposes of guiding users.	ICPAK, PSASB, CBK, SASRA, CMA, IRA, RBA
		The requirement by some sectors to publish quarterly financial statements is tedious.	The publishing of quarterly returns is a requirement by law. Therefore, companies should employ more resources e.g i. Capacity building. ii. Robust ERP systems to flag issues in good time.	Preparers, Management
		Misstatement in preparation of financial statements	Adherence to ethical standards	ICPAK
		Numerous and complex IFRS disclosure requirements affect compliance	Frequent training sessions for preparers	ICPAK
<b>Efficiency and Effectiveness</b>				
4.	Efficiency	Lack of timely provision of sufficient information from management/user departments	Cooperation and supply of correct information by management/user departments	Management

	Thematic Area	Challenges	Recommendations	Responsibility
		Feedback on financial statement reviews submitted for Financial Reporting (FiRe) awards is not given in time.	Provide timely reviews to all entrants to enable continuous improvement in financial reporting	ICPAK, NSE, CMA, PSASB
		There are many IFRS quoted in financial statements which cannot be easily understood by untrained readers	Capacity building of users	ICPAK
		A low number of qualified professionals in entities	Mobilize resources (technological, human capital).	Management
			Capacity building of existing staff	ICPAK, Management
		Communication and presentation of financial statements when dealing with stakeholders of different levels of education.	Capacity building of users to enhance skills, knowledge and attitudes.	ICPAK, CBK, SASRA, CMA, RBA, IRA.
5.	MANAGEMENT	Management team not aware of the disclosures required for preparation of financial statements under full IFRS or IFRS for MSMEs	Capacity Building of management	Management, ICPAK
6.	AUTOMATION	The format required by regulators vs the software format used is completely different	Robust software that captures the required information and links both the regulators and users should be used e.g IFMIS for GOK	The National Treasury, Ministry of ICT, Regulators
		Lack of reliable software to enhance efficiency and accuracy	The Institute should adopt formulated excel spreadsheets for practitioners	ICPAK
		Automation of some aspects of accounting like depreciation is lacking	Invest in software	Preparers, Management

## CHAPTER IV:

# Reflection of The Regulators





## INTRODUCTION

This subsection seeks to answer the following research question: what are the interventions provided by regulators in the reading and understanding financial statements by users in Kenya? The subsection comprises of the following: type of regulators and their mandate and the challenges faced by regulators in the field of financial statements preparation and communication to the users.

As a guarantor of public interest, governments require financial statements for purposes of accountability, regulation, taxation, monitoring and evaluation of programs. To achieve this, they have agencies in place that regulate and oversee financial management, companies and financial markets. These agencies have a specific range of duties and responsibilities that enable them to act independently of each other while they work to accomplish their objectives.

The goal of regulation is to prevent and investigate fraud, keep markets efficient, effective and transparent, and ensure that customers and clients are treated fairly. In Kenya, there are various regulatory agencies with their mandates as illustrated in the table below.

Table 5: Regulatory Agencies and their Mandates

No.	Agency	Legal Instrument	Mandate
1.	Institute of Certified Public Accountants of Kenya	Accountants Act, 2008	<ul style="list-style-type: none"><li>• To regulate the accountancy profession in Kenya</li><li>• To promote standards of professional competence and practice amongst members of the Institute</li><li>• To promote research into the subject of accountancy and finance and related matters, and the publication of books, periodicals, journals and articles in connection therewith</li><li>• To promote the international recognition of the Institute.</li><li>• To advise the Examination Board on matters relating to examinations standards and policies</li><li>• To advise the Minister on matters relating to financial accountability in all sectors of the economy</li></ul>
2	Central Bank of Kenya (CBK)	Anchored in the Constitution under Article 231 and The Central Bank of Kenya Act of 1966	To formulate and implement monetary policy that promotes price stability, fosters liquidity, solvency and stability of the banking sector, issue currency notes and coins, and provide banking services to the Government, commercial banks and other financial institutions.

Table 5: Regulatory Agencies and their Mandates

No.	Agency	Legal Instrument	Mandate
3.	Insurance Regulatory Authority (IRA)	Insurance Act (Amendment) 2006	<ul style="list-style-type: none"> <li>• Ensure the effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya;</li> <li>• Formulate and enforce standards for the conduct of insurance and reinsurance business in Kenya;</li> <li>• License all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters and assessors, risk surveyors and valuers;</li> <li>• Advise the Government on the national policy to be followed in order to ensure adequate insurance protection and security for national assets and national properties;</li> <li>• Issue supervisory guidelines and prudential standards from time to time, for the better administration of the insurance business of persons licensed under this Act;</li> <li>• Conduct inquiries and share information with other regulatory authorities and to carry out any other related activities in furtherance of its supervisory role;</li> <li>• Educate the public regularly on the right to independently select an underwriter or broker from a list of underwriters or brokers licensed by the Authority;</li> <li>• Regulate the business of bank assurance offered by banks in the same manner as the ordinary insurance business including capital requirements and disclosures</li> </ul>
4.	Retirement Benefits Authority (RBA)	Retirement Benefits Act NO. 3 of 1997	<ul style="list-style-type: none"> <li>• Regulate and supervise the establishment and management of retirement benefits schemes;</li> <li>• Protect the interests of members and sponsors of the retirement benefits sector;</li> <li>• Promote the development of the retirement benefits sector</li> <li>• Advise the Cabinet Secretary, National Treasury on the national policy to be followed with regard to retirement benefits industry</li> <li>• Implement all government policies relating to the industry</li> </ul>
5.	Sacco Societies Regulatory Authority (SASRA)	Sacco Societies Act, 2008	<ul style="list-style-type: none"> <li>• License Sacco societies to carry out deposit-taking business in accordance with the Act;</li> <li>• Regulate and supervise Sacco societies;</li> <li>• Hold, manage and apply the General Fund of the Authority in accordance with the provisions of the Act;</li> <li>• Levy contributions in accordance with the Act;</li> <li>• Do all such other things as may be lawfully directed by the Cabinet Secretary;</li> </ul>

No.	Agency	Legal Instrument	Mandate
6.	Capital Markets Authority (CMA)	Capital Markets Act, 1989	<ul style="list-style-type: none"> <li>• The development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for longer term;</li> <li>• To facilitate the existence of a nationwide system of securities commodities market and derivatives market and brokerage services so as to enable wider participation of the general public in the securities market and derivatives market;</li> <li>• The creation, maintenance and regulation, of a market in which securities can be issued and traded in an orderly, fair, and efficient manner, through the implementation of a system in which the market participants are self-regulatory to the maximum practicable extent;</li> <li>• The protection of investor interests;</li> <li>• The facilitation of a compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual obligations; and</li> <li>• The development of a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya.</li> </ul>
7.	Public Sector Accounting Standards Board (PSASB)	Public Financial Management Act, 2012	<ul style="list-style-type: none"> <li>• Set generally accepted accounting and financial system standards for the Public Sector.</li> <li>• Prescribe and pronounce generally accepted internal auditing standards.</li> <li>• Mainstreaming of best practices for good governance, internal controls and risk management in the Public Sector.</li> </ul>

Source: Kenya Law Reports Websites.

In this research study, data was also collected from the regulators in the financial industry in Kenya who included: The Capital Markets Authority, The Insurance Regulatory Authority, The SACCO Societies Regulatory Authority and The Retirement Benefits Authority. The regulators responded through an open-ended questionnaire on matters to do with printing financial statements and the simplicity of the content of the financial statements.

## FINDINGS

The study sought to gather financial regulators' insights on policy matters guiding the readability and understandability of financial statements in Kenya. Specific focus was on printing of financial statements, the cost-benefit analysis of posting, legal and regulatory framework on publishing financial statements and simplification of financial reports.

Below are the findings on the study focus areas:



## Printing of Financial Statements

- a) Posting of financial statements is currently not necessary since publication can be uploaded and obtained on company websites.
- b) It is cost-effective to publish financial statements online compared to printing and posting of the same to shareholders and stakeholders.
- c) Preparation and submission of financial statements is required in the public sector. Section 68 of the Public Finance Management (PFM) Act 2012 provides for preparation and submission of financial statements to the Office of the Auditor General, Controller of Budget and the National Treasury. However, the Act has no specific provision on printing.
- d) Printing and posting of financial statements should be considered in cases where there is no internet network or where the shareholders have placed a request for printed financial statements to be posted to them.
- e) Majority of the older generation users of financial statements still prefer hard copy while younger users prefer the online version.
- f) The relevant laws (including the Public Finance Management Act 2012 and the Companies Act 2015) should provide clarity on both printing and online posting of financial statements depending on the preference of the user. For example, the Companies Act, 2015 only obligates quoted companies to publish their financial statements on their websites.
- g) The respondents opined that as long as the financial statements are received in good time, to make decisions, the method of delivery (whether physical or online) might not be relevant.

## Readability and Understandability of Financial Statements

- a) There is no difference in the concepts of readability and understandability of financial statements whether printed or online. It all depends on whether users have the capacity to comprehend the basics of financial statements.
- b) A lot of information within the financial statements may not be easily understood by users without an accounting or finance background.
- c) There is a need to publish two sets of financial statements, that is, a simplified version and a detailed report to serve management, shareholders, and other users with varying needs and capabilities. In this case, shareholders will be able to peruse important information while the detailed version will depict the company's financial health.

## Observations and Conclusion

The general observation was that printing of financial statements for users is unnecessary as long as the entity can upload them on their website. However, there should be a consideration for exceptional cases to accommodate user needs such as those in remote areas. Preparers should consider preparing simplified versions alongside detailed reports of financial statements. Aside from quoted companies, legal provisions do not provide for a mandatory requirement for companies to have working and updated websites for posting financial statements. In addition, there is no provision on the minimum number of financial year reports which should be availed on companies' websites at any given time.



## RECOMMENDATIONS

The following are recommendations based on findings from financial sector regulators.

Table 6: Recommendations based on Findings from Regulators

No.	Recommendation	Rationale	Responsibility
	<b>Printing of Financial Statements</b>		
1.	Entities should consider availing approved published financial statements on their websites, in addition to printed copies (hard copies)	<ul style="list-style-type: none"> <li>• Cost effective</li> <li>• Enhanced accessibility</li> <li>• Aligns with COP 26 agenda on climate change and SDG 13</li> </ul>	Preparers Company Directors
2.	Review provisions on preparation, submission and presentation of financial statements in relevant laws (Public Finance Management Act 2012, Companies Act 2015 and other Acts)	<ul style="list-style-type: none"> <li>• To promote clarity</li> </ul>	Regulators Policymakers Legislators
3.	Timely preparation and presentation of financial statements as stipulated by statute and other relevant guidelines.	<ul style="list-style-type: none"> <li>• To enhance decision-making by stakeholders</li> </ul>	Preparers Company Directors
4.	Publish financial statements for at least the last five years on a company's website.	<ul style="list-style-type: none"> <li>• To enhance decision-making</li> </ul>	Preparers Company Directors
5.	Promote access to financial information by encouraging companies to have a working and updated website.	<ul style="list-style-type: none"> <li>• To facilitate accessibility of financial statements</li> </ul>	Regulators Legislators
6.	Consider preparing simplified versions (without losing intended meaning) alongside detailed reports of financial statements.	<ul style="list-style-type: none"> <li>• To enhance the readability and understandability of financial statements.</li> </ul>	Regulators Preparers Company Directors
7.	Collaborate to develop parameters for guiding preparation of simplified financial statements.		IFAC ,Regulators National Treasury Parliament
8.	Amend relevant laws and standards to facilitate use of simplified language	<ul style="list-style-type: none"> <li>• To enhance the readability and understandability</li> </ul>	IFA, ICPAK Legislators Other Regulators
9.	Collaboration to offer training to users on financial literacy, the readability, and understandability of financial statements as part of Corporate Social Responsibility.	<ul style="list-style-type: none"> <li>• To enhance the readability and understandability</li> </ul>	Regulators Preparers KSG
10.	ICPAK in collaboration with other regulators to conduct free public awareness forums on readability and understandability of financial statements semi-annually as part of Corporate Social Responsibility.	<ul style="list-style-type: none"> <li>• To promote the readability and understandability of financial statements</li> </ul>	ICPAK Other Regulators KSG



No.	Recommendation	Rationale	Responsibility
11.	Users without accounting or finance background should be encouraged to engage a registered professional for interpretation of financial statements	<ul style="list-style-type: none"><li>To enhance decision-making</li></ul>	Users of financial statements



# General Conclusions & Recommendations



## CONCLUSION

The main objective of this study was to assess the extent of readability and understandability of financial statements by users in Kenya. Various groups of stakeholders such as investors, regulators, lenders, customers, competitors and the public use financial statements to understand the financial stability of a company. The findings of this study show that users of financial statements face a lot of challenges that limit the readability and understandability of financial statements. These challenges include the increased complexity of financial statements, the use of technical jargon, information overload and the frequent changes in accounting standards. It is therefore considered important that any future developments in financial reporting assist financial statement users to ensure that information provided is readable and understandable.

The findings revealed that a majority of users sought the services of professionals to assist them in understanding financial statements due to the complexity of financial statements amongst users. There is therefore need to improve on the readability and understandability of the financial statements. Both the preparers and regulators have a responsibility to ensure financial statements are understood by users.

The study also assessed the effectiveness and efficiency of publishing financial statements in Kenya. Publication of financial statements is important since it enables the users to understand the financial performance and make investment decisions in an organization. The results obtained from the study indicate that a majority of preparers of financial statements often include a summarized version when publishing financial statements. Further, the findings indicate that a majority of firms share their financial statements to their users by posting on their websites and via email. This is attributed to advancements in technology and creates room for publication and publicizing of financial statements. However, there are a few firms that share their financial statements via the post office and hand delivery. Section 670 of the Companies Act makes it mandatory for the quoted companies, in addition to submission, to post their annual financial statements and directors' reports on the companies' websites where they will remain posted until the next reports are published and posted.





## RECOMMENDATIONS

Table 7: Recommendations based on Findings from Regulators

No.	Recommendation	Rationale	Responsibility
1	There is a need to present financial statements in both Kiswahili and English and versions that are favorable to different users including persons abled differently.	To enable the users to receive the financial information in the language that they are most conversant with and proficient in.	PSASB, ICPAK
2.	Entities should publish the financial statements for the last five years on their websites to enhance intra-company comparison.	To enhance decision-making by the users	Preparers Company Directors
3.	The preparers should consider accompanying financial ratios with explanations and they should avoid use of jargon in financial statements.	To enhance readability and understandability of financial statements	Preparers
4.	Consider preparing simplified financial statements (without losing intended meaning) alongside detailed reports of financial statements.	To enhance readability and understandability of financial statements	Regulators Preparers
5.	Conduct training workshops and training programs on financial literacy, readability, and understandability of financial statements.	To enhance readability and understandability of financial statements	Regulators Preparers
6.	Constantly communicate the changes in reporting standards and formats to users and preparers.	To enhance readability and understandability of financial statements	ICPAK/PSASB
7.	Ensure that financial statements are accessible in formats that can be consumed by people who are abled differently, especially those with visual impairment.	To enhance the readability and understandability of financial statements	Regulators
8.	Provide standardized/industry specific financial reporting templates for the NGO sector. Capture all data that reflects the NGOs and provide a template like the National Treasury and PSASB do for the public sector.	To ease comparison	ICPAK NGO Coordination Board
9.	Timely release of reporting templates	To ensure timely preparation and presentation of financial statements.	ICPAK/PSASB

No.	Recommendation	Rationale	Responsibility
10.	Standardize IFMIS Module	To enhance comparison	National Treasury
11.	Harmonize the frameworks for guiding regulation and compliance in financial reporting.	For purposes of guiding users.	Regulators
12.	University accounting lecturers should be encouraged to pursue professional courses in accounting and finance and attend ICPAK trainings.	In order to update their knowledge in the field	University management



# Limitations of the Study & Recommendations for future studies



## LIMITATIONS OF THE STUDY

1. The study was conducted at the height of COVID-19. The containment measures affected the choice of data collection method and reaching out to the target population. To mitigate this, researchers adopted electronic data collection mechanisms.
2. The choice of the mechanism adopted limited researchers from reaching targeted population that did not have internet access and connectivity. To remedy this, researchers increased the sample size and targeted respondents with internet access and connectivity.
3. Affordability of electronic gadgets to the vulnerable population hindering their participation in the study.
4. Low financial literacy levels among some of the users hindered their ability to respond effectively.
5. The tool was designed to reach those who can read hence excluding other vulnerable groups such as the visually impaired.

## RECOMMENDATION FOR FUTURE STUDIES

1. Focus on collecting and analyzing data on readability and understandability of financial statements from vulnerable groups using a tool that is suitable for the group like non-digitized questionnaires.
2. Compare financial statements of different entities or industries for readability and understandability by users.
3. Investigate the extent to which companies have functional websites, to what extent the websites are up to date with financial statements and whether the financial statements posted in the websites are identical to the audited version of financial statements.
4. Focus on the translatability of financial statements into Kiswahili.



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## APPENDIX 1: GLOSSARY

### *Financial Statements.*

Statement of Profit or Loss and other Comprehensive Income, Statement of Changes in Equity, Statement of Financial Position, Statement of Cashflows, Notes to the Financial Statements.

### *Users/Readers.*

These include different sets of individuals and entities interested in the contents of the financial statements.

### *Readability.*

Refers to the linguistic characteristics of a text and impacts on the ease with which a reader can be able to read and understand the text

### *Understandability.*

Refers to a reader's ability to make meaning of the financial statements and is thus affected by the reader's characteristics such as interests, background, prior knowledge, and readability.

### *Information Asymmetry.*

An imbalance between the information possessed by two parties in a transaction whereby one party has more information than the other which they can exploit e.g preparers have more information than the readers of financial statements.

### *Fog Readability Index.*

Refers to a readability test that aims to determine the level of text difficulty, or how easy a text is to read. The index provides a reader with the number of years of education that he or she hypothetically needs to understand and digest a particular text on the first reading.

### *Flesch Readability Index.*

A widely used readability formula which assesses the approximate reading grade level of a text. It is a test designed to indicate how difficult a passage is in English to understand.

### *Accountant.*

A person registered as an accountant under Section 24 of the Accountants Act and is a member as defined in Section 4 (2)(a) and (b) with expertise achieved through formal education and practical experience, and shall be held to a high professional standard in respect to demonstrating and maintaining competence in accountancy in line with International Accounting standards; compliance with the Institute's code of ethics; maintaining good standing status and subject to enforcement of the rules and regulations of the Institute.

### *Full member of ICPAK.*

Is a member registered under section 24 each of whom shall be titled "Member of the Institute of Certified Public Accountants of Kenya" (designatory letters C.P.A. (Kenya)

### *Practicing member of ICPAK.*

Is a registered member of the Institute who is licensed to practice accountancy in accordance Section 2 and Section 19 (1) (d) of the Accountants Act.

### *Associate member of ICPAK.*

Is a person eligible to be registered under section 26 of the Accountants Act but who do not meet all the requirements prescribed under subsection (1) of that section.





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