



## Top Management Team Diversity and the Moderating Effect of Discretionary Accounting Choices on Financial Reporting Quality among Commercial State Corporations in Kenya

Nixon Oluoch Omoro

University of Nairobi, School of Business, Department of Finance & Accounting, Kenya.  
Email: [nixonomoro@gmail.com](mailto:nixonomoro@gmail.com)

### Abstract

The study aims to examine the moderating effect of discretionary accounting choices on the relationship between top management demographic diversity and financial reporting quality among state commercial firms in Kenya based on 248 firm-year observations for 2004 -2015. The study used correlational research design to achieve the sought objectives. It lays a broad foundation for the future research work into the theory and practice of financial reporting quality in commercial state corporations. The findings clearly reveal that, there exist both positive and negative relationship between discretionary accounting choices and financial reporting quality. However, the relationship varies with each financial reporting quality proxy measures. The demographic variables that were statistically significant in explaining FRQ were; age, education, tenure, gender and functional background diversity. Hence, managerial characteristics matter in explaining discretionary accounting choices and financial reporting quality in the companies. Despite the findings showed minimal significant effects on earnings quality and timeliness. Discretionary accounting choices should not be used by the management opportunistically but should be used to enhance quality reporting. The study recommends that stakeholders in commercial state corporations should ensure that discretionary accounting choices is improved to decrease manipulations of accounting information in order to increase the quality of reporting.

#### Keywords:

*Top management team  
Manager's characteristics  
Discretionary accounting choices  
Financial reporting quality.*

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### 1. Introduction

The top management characteristics and optional accounting decisions have been major focal points for many researchers in exploring how they impact on quality reporting. However, a section of researchers believe that top management diversity and discretionary accounting choices are often used by top management for opportunistic reasons not for quality reporting (Bamber, Jiang, & Wang, 2010; Finkelstein, Hambrick, & Cannella, 2008; Ge, Matsumoto, & Zhang, 2011; Omoro, Aduda, & Okiro, 2015). Basing the argument on the upper echelon, agency theory, political cost theory and discretionary-based disclosure theory (Hambrick & Mason, 1984; Verrecchia, 2001; Watts & Zimmerman, 1978) it is important to investigate how the top

management characteristics and optional accounting choices may influence quality reporting among state commercial firms. Although it is noted that accounting conventions and policies dictate the procedures for deriving quality reporting, there still exist managerial characteristics and discretionary opportunities to manipulate accounting records that affects reporting quality in the long-run.

The managerial discretion may be explained along accounting policies on depreciation methods, inventory costing methods, revenue recognition, and cost of goods sold, reserves and allowances, contingent liabilities, advertising market expenditure and pension plans (Omoro et al., 2015). The studies that indicate much of the variations in financial reporting quality are not explained fully by variables such as firm level characteristics, corporate governance and executive compensation (Bertrand & Schoar, 2003; Francis, Nanda, & Olsson, 2008). This makes it more interesting to explore more on other factors, given that accounting information quality is multi-dimensional. Managers' demographic diversity effect has been used in other studies to explain changes in discretionary accruals, earning smoothing, voluntary disclosures with no conclusive findings (Bamber et al., 2010). Biddle and Hilary (2006) and Lambert, Leuz, and Verrecchia (2007) suggested that no conclusive research has been done on quality reporting by firms given the diversity and variations in measurements. Empirical studies by Collins, Pasewark, and Riley (2012) and Agoglia, Douppnik, and Tsakumis (2011) found differences between accounting choices by managers working under rather strict regulatory systems when compared to those working under rather flexible systems, although in the latter no rather scattered outcomes have been found, but it is hypothesized that this arrangements may affect quality reporting.

The motivation to explore much on commercial state corporations is that most of the registered firms have been performing poorly and riddled with high corruption and corporate scam cases. It is therefore expected that their quality reporting should be like those of the listed companies. This is on the pretext that financial reporting practices are perceived to have improved significantly after ICPAK's decision to implement IFRSs. Since then, the quality of reporting among Kenyan companies has been a major concern from various stakeholders (Barako, 2007). According to the World Bank Report 2001 in Kenya on observance of standards and codes (ROSC, 2001) reveals gaps between applicable standards and accounting practices in many companies. The study by Center for Governance and Development (CGD 2005) in Kenya on audited accounts of state corporations reveals in-accuracy on most accounts of state corporations. IFAC (2005) confirmed that requirements for adopting International Financial Reporting Standards (IFRSs) have been legalized in Kenya for enterprises of all types. This therefore confirms that the IFRSs are in use and applicable in commercial state corporations in Kenya to enhance quality reporting. However, there has been laxity in quality reporting among many state commercial corporations due to lack of good will and commitment. Infact it was not until 2014 when treasury, the auditor general and Ernest and Young teamed up to steer the IPSAS adoption in the central government that the implementation actually commenced. It is also a requirement by the Kenyan companies Act 2015, that directors prepare financial statement for each financial year which portrays true and fair view.

Most of the empirical studies show that discretionary accounting choices and top management characteristics have impact on quality reporting (Bamber et al., 2010; Ge et al., 2011). But this may not be a consensus given that most researcher have measured quality reporting differently (Biddle & Hilary, 2006) and Lambert et al. (2007). This position is well documented by IASB (2008) that financial reporting quality does not only means earnings or stock price changes, but a multi-dimensional term that requires comprehensive measure. Top management across many firms are believed to use flexibility within the accounting standards to choose accounting methods, policies and estimates in financial reporting process which influence positively or negatively the firm's financial reporting quality. This assertion is based on the discretionary-based disclosure theory which provides the conceptual and theoretical framework used to examine the incentives that motivate corporate voluntary disclosure (Verrecchia, 2001). This theory evaluates under which circumstances companies choose to disclose or not disclose certain kinds of information in their financial statements.

## **2. Theoretical and Empirical Perspectives**

Agency theory claims that conflicts are expected to arise when there is incomplete and asymmetric information. Giner (1997) notes that managers will disclose more information or detailed information associated with agency problem. Determinants of disclosure are size, leverage, profitability and listing status. Agency problem is caused by top management characteristics. García-Meca, Parra, Larrán, and Martínez (2005) argues that disclosure serves to control agency cost. Lundholm and Winkle (2006) note that company's disclosure more when information is positive and less when there is friction such as information asymmetry and propriety costs. The most interesting part of the effect is on how the TMT personal characteristics would influence this disclosure in CSCs. Upper Echelon Theory explains that top management's characteristics (education, age, sex and tenure) influence the decisions that they make and thereafter the actions adopted by the organizations that they lead. This is due to the fact that demographic characteristics are associated with many cognitive bases, values and perceptions that influence the decision making of top management (Hambrick & Mason, 1984).

Ling (2012) shows that individual managers play significant role in explaining how accounting accruals is influenced by accounting choices over time. Dechow and Schrand (2004) explored how top managers are able

to exercise discretion over reported earnings along various dimensions (aggressive, conservative and smoothing reporting). Each of these dimensions has intervening effect on financial reporting quality and demographic diversity of TMT since there seem to be indirect relationship. However, audit committee serve as a bridge in the communication network between internal and external auditors and the board of directors. Audit committee help to check the activities of the auditors (both internal and external) and top management resulting to the bridging of the gap among users of financial statements (Enofe, Ediae, & Ejiemen, 2013).

Hribar and Yang (2010); Ling (2012); Helson (1998) explained candidly how individual managers have great potential to enhance understanding of how managers consequently make financial reporting choices. Hribar and Yang (2010) have used demographic diversity of TMT as independent variable on discretionary accounting choices. Hitt, Ireland, and Hoskisson (2001); Cohen, Ganesh, and Wright (2004); Bamber et al. (2010) and Francois and Kyle (2011) have used demographic diversity of TMTs as independent variable on proxies of FRQ. In choosing activities, managers must often tradeoff between what to disclose and the expected value to be reported. Therefore corporate voluntary disclosure plays the role of tradeoff between the manager's incentives and the desired firm outcomes. Thus with corporate disclosure managers can influence the expected interpretation of financial reporting components. Since none of these studies has tested the causal linkages of the three variables, this leads to the preposition that: The relationship between demographic diversity of top executives and financial reporting quality is not mediated by discretionary accounting choices.

Quite a number of studied carried out in Kenya failed to clearly explain on how top management characteristics and discretionary accounting choices influence reporting quality in state commercial enterprises (Kariuki & Jagongo, 2013; Mutiso & Kamau, 2013). However, a study by Outa (2011) pointed out that quality reporting in Kenya was generally low. The study used the proxies such as quality disclosure index and compliance index as a measure of quality reporting. However, the reviewed local studies reveal that most studies basically rely on IFRSs in explaining the level of FRQ in listed companies but are quite silent about commercial state corporations.

From the international perspective, the Foundation Institute for Accounting Actuarial and Financial Research and Ernst & Young (2013) reports that any discretionary "change from rule-based accounting to principle-based accounting." Would affect the quality of reporting of firms. Thus regulatory flexibility increases the complexity of procedures for recognizing, measuring, and disclosing accounting information, thus, greater subjectivity and higher degree of judgment were provided to the statements.

### *2.1. Methods and Measures*

The study adopted correlational research design to indicate an association between the variables (Creswell, 2008; Lodico, Spaulding, & Voegtler, 2006). The study sampled firms' yield firm year observations of 248 individual TMTs and annual financial statements from a group of none classified 30 state commercial corporations. The firm year observation was use as the sample size for the study. The commercial state corporations were preferred for the study as they have well defined financial reporting framework and defined procedures for appointment of top management. Where secondary data was extracted from audited financial reports. The study therefore sought to explain the model:

$$FRQ = \beta_0 + \beta_1 Gen + \beta_2 Edu + \beta_3 Age + \beta_4 Ten + \beta_5 FBG + \beta_6 ACPL + \varepsilon$$

Where: the model have three distinct variables:

**FRQ** =Financial reporting quality. It is measured using four different proxies namely; fundamental qualitative characteristics of accounting information, quality disclosures in annual reports, timeliness of reports and earnings quality).

### *2.2. Top Management Demographic Characteristics*

- Gen = Gender diversity of top management team.
- Edu =Education Background diversity of top management team.
- Age = Age diversity of top management team.
- Ten = Tenure diversity of top management team.
- FBG = Functional background diversity of top management team.

### *2.3. Discretionary Accounting Choices*

ACPL = Discretionary Accounting policies and methods.

## **3. Presentation and Analysis of Results**

Discretionary accounting measurement policies were measured using dummy variables (1 or 0) to determine the level of discretionary accounting choices made thus- if aggressive choices in the discretionary accounting policies. If accounting choice in year is coded '1' if the aggressive policies are chosen by management or zero (0) is conservative accounting policies is selected. The study sought to determine the extent to which commercial state corporations use aggressive accounting policies in valuation and estimation of revenues earned, cost of sales, inventories, depreciation of fixed assets, allowances and contingent liabilities.

The descriptive statistics indicate that for accounting policies across all observations had overall mean of 0.60415 which is above average. This shows that most of the firms preferred aggressive policies in the preparations of financial statements. The use of aggressive of conservative accounting policies in revenue recognition, inventory valuation, estimates of provisions, bad debts and contingent liabilities was almost consistent. Through content analysis it was clear that almost all commercial state corporations clearly disclosed on any change of accounting policies and estimates. The policies used were adequately supported by relevant IFRSs and justification for the use provided. For example the depreciation method used across the commercial state corporations was basically straight line method and on revenue recognition there were variations across the corporations. The results are shown in Table 1.

Table-1. Analysis of variance on discretionary accounting policies.

Source of variation		d.f.	s.s.	m.s.	Variance ratio.	Fpr.
Firm		29	4.00571	0.13813	4.3	P<0.001
Residual		211	6.77014	0.03209		
Total		240	10.77585			
d.f.	Mean	standard error		coefficient of variation		
211	0.60415	0.1791		29.6		

Researcher sought to examine how discretionary accounting choices are influenced by demographic diversity of top management team in Kenyan commercial state corporations. From the theory and empirical findings, demographic diversity of top management has provided mixed results with accounting choices. Most studies have looked at the effect of diversity across CFOs, CEOs, BoDs and audit committee. The accounting choices have also varied across each study. The findings are mixed with some demographic factors providing significant positive relationship on discretionary accounting choices and other studies providing negative relationship with varied discretionary accounting choices. The focus of this study was on the five discretionary accounting choices namely; revenue recognition policies, inventory and cost of sales methods, depreciation methods, provisions and bad debts and contingent liabilities. It would be expected, therefore that, demographic diversity would not have significant effect on discretionary accounting choices made by top management team in commercial state firms. In order to test the hypothesis multiple linear regressions was conducted. The results from regression analysis are presented in Table 2a.

Table-2a. Regression results for demographic diversity and discretionary accounting choices.

Model		Unstandardized Coefficients		Standardized Coefficients	T	F	R	R <sup>2</sup>	AdjR <sup>2</sup>	Sig.
		B	Std. Error	Beta						
1	(Constant)	.447	.063		7.082	7.172	0.366	0.134	0.115	.000
	Age	.044	.046	.061	.963					.337
	Tenure	.085	.041	.127	2.053					.041
	Gender	-.040	.053	-.046	-.740					.460
	Education	.282	.055	.335	5.114					.000
	FBG	-.153	.063	-.157	-2.418					.016

The linear regression results (beta = 0.61, 0.127, 0.335 and -0.157, t= 0.963,2.053, 5.114 and -2.4418 respectively with, p < 0.05).The findings presented in Table 2a shows that adjusted R<sup>2</sup> is (0.115) meaning only 11.5% of the variation in discretionary accounting choices is explained by the combination of three demographic diversity variables, namely ; tenure, education and functional background. This is an indication that education diversity is positively (B=0.334) associated with discretionary accounting choices made by top management, hence, has the highest contributing coefficient factor then followed by tenure diversity (B= 0.127). The implication is that a unit change in education diversity and tenure diversity would result to an increase in the use of discretionary accounting policies by 33.4% and 12.7% respectively. Functional background of the TMTs is inversely related to discretionary accounting choices made by top management (beta= -0.157). Meaning a change in the functional diversity results into a decrease in the use of aggressive accounting policies. The finding is consistent with past empirical findings and theoretical understandings. For example Bamber et al. (2010) finds positive relationship between functional backgrounds of CEOs with accounting choices made within the firm.

We further conducted the Pearson's product moment correlation coefficient for demographic diversity (age and education) of top management was (r =0.127 p<0.05 and 0.307 p<0.01respectively) in Table 2b, it shows that at least two variables (age diversity and education diversity is positive and significantly related to

discretionary accounting choices made by TMTs. Thus the rejection of the null hypothesis that there is no significant effect of demographic diversity of TMTs on discretionary accounting choices.

**Table-2b.** Correlation between demographic diversity and discretionary accounting choices.

Correlations								
		Age	Tenure	Gender	Educa	FBG	ACPL	VOLDC
Age		1	0.024	-.136*	0.207**	0.09	.127*	-0.125
	Sig.		0.714	0.035	0.001	0.166	0.049	0.053
Tenure		0.024	1	-0.079	0.042	0.121	0.122	0.104
	Sig.	0.714		0.224	0.515	0.062	0.059	0.108
Gender		-.136*	-0.079	1	-0.013	0.009	-0.076	0.035
	Sig.	0.035	0.224		0.843	0.893	0.24	0.586
Educa		.207**	0.042	-0.013	1	.313**	.307**	-0.023
	Sig.	0.001	0.515	0.843		0	0	0.724
FBG		0.09	0.121	0.009	313**	1	-0.03	-0.012
	Sig.	0.166	0.062	0.893	0		0.646	0.853
ACPL		.127*	0.122	-0.076	307**	-0.03	1	0.113
	Sig.	0.049	0.059	0.24	0	0.646		0.08
VOLDC		-0.125	0.104	0.035	-0.023	-0.012	0.113	1
	Sig.	0.053	0.108	0.586	0.724	0.853	0.08	

Note: \*.Correlation is significant at the 0.05 level (2-tailed).

\*\* .Correlation is significant at the 0.01 level (2- tailed).

The **Table 2b** shows that discretionary accounting policies are positively (0.127,  $p < 0.05$ ) associated with age diversity. This signifies that the more diverse the age of TMT, the more an aggressive accounting policies will be selected. It also shows that education diversity has positive relationship with discretionary accounting policies (0.307,  $p < 0.01$ ). This implies that the selection of aggressive accounting policies will increase with the diversity in education in the TMT of the commercial state corporations.

In our second analysis the researcher sought to determine the relationship between discretionary accounting choices and quality financial reporting in commercial state corporations. From empirical studies, accounting choices are channels through which managers affect financial reporting quality. Most of the studies reviewed have so much concentrated in measuring quality reporting using different proxies such as earnings management, but this is not the only measure, there are other proxies that can be used - disclosure quality index, fundamental qualitative characteristics indices and timeliness in reporting. Therefore, it is anticipated in this study that the use of discretionary accounting choices would not have any significant relationship with other FRQ proxies. Hence, the hypothesis was tested and results reported in **Table 3a, 3b** and **3c**.

This Hypothesis was sub divided into four sub-hypotheses in order to test for the effect of discretionary accounting choices on the four proxies of financial reporting quality.

*H 02a: Discretionary accounting choices have no significant relationship with disclosure quality in commercial state corporations in Kenya.*

*H 02b: Discretionary accounting choices have no significant relationship with fundamental qualitative characteristics in commercial state corporations in Kenya.*

*H 02c: Discretionary accounting choices have no significant relationship with earnings management quality in commercial state corporations in Kenya.*

*H 02d: Discretionary accounting choices have no significant relationship with timeliness quality in commercial state corporations in Kenya.*

Multiple linear regression analysis and correlations analysis were conducted on the four proxies of FRQ independently to test for the level of significance within the relationship.

*H 03a : Discretionary accounting choices have no significant relationship with disclosure quality in commercial state corporations in Kenya.*

The result of Pearson correlations shows a correlation coefficient of  $r=0.016$ ,  $p > 0.05$ . This is an indication of no relationship in the model. To confirm whether there is a relationship between discretionary accounting choices and disclosure quality, ordinary least square analysis was conducted and results presented in **Table 3a**.

**Table-3a.** Regression results on the effect of discretionary accounting policies on disclosure quality.

Model	R	R square	Adjusted R square	Std. Error of the estimate	F	Sig.
1	.016a	0	-0.004	0.225033636	0.059	0.808(a)

Based on the results in **Table 3a**,  $R^2$  of (0.00) and adjusted  $R^2$  is (-0.004) which confirms that the variation in disclosure quality is not explained by discretionary accounting choices. The implication is that discretionary accounting policies are one of the mandatory components of overall disclosure quality. Therefore



with R-square of 0.0, the F value of 0,059 is insignificant (Sig. =0.808) the discretionary accounting choices made in commercial state corporations, thus, the model is not a good predictor of disclosure quality in CSCs in Kenya, hence,  $H_{03a}$  is confirmed.

The second sub hypothesis, *Discretionary accounting choices have no significant relationship with fundamental qualitative characteristics in commercial state corporations in Kenya*, was then tested. Pearson moment correlation was used as to test for the relationship. The results from Table 3b (i) shows a correlation coefficient of  $r=0.045$ ,  $p>0.01$ . This means there is no significant relationship between the two variables. In order to confirm the effect of discretionary accounting policies on fundamental qualitative characteristics, OLS was conducted and results of the findings are shown in Table 3b (ii) below :

Table-3b(i). Correlations between discretionary accounting choices and FRQ.

Correlations						
		Dquality	Earnings	QCharc	Timeliness	ACPL
Dquality	Pearson correlation	1	-0.005	0.194**	0.031	0.016
	Sig. (2-tailed)		0.938	0.003	0.634	0.808
Earnings	Pearson correlation	-0.005	1	-0.197**	0.076	0.051
	Sig. (2-tailed)	0.938		0.003	0.253	0.441
Qcharc	Pearson correlation	0.194**	-0.197**	1	-0.373**	0.045
	Sig. (2-tailed)	0.003	0.003		0	0.485
timeliness	Pearson correlation	0.031	0.076	-0.373**	1	-0.113
	Sig. (2-tailed)	0.634	0.253	0		0.08
ACPL	Pearson correlation	0.016	0.051	0.045	-0.113	1
	Sig. (2-tailed)	0.808	0.441	0.485	0.08	

Note: \*\*. Correlation is significant at the 0.01 level (2-tailed).

Table-3b(ii). Regression results on the relationship between discretionary accounting policies and fundamental qualitative characteristics.

Model	R	R square	Adjusted R square	Std. Error of the estimate	F	Sig
1	.045a	0.002	-0.002	0.671942265	0.489	0.489(a)

The results from Table 3b shows that  $R^2 =0.002$  and adjusted  $R^2 -0.002$ , this implies that the model is not a good predictor, at p value =0.485. Hence  $H_{03b}$  is confirmed.

The empirical studies and theoretical understandings is that discretionary accounting choices may be used to manage earnings, therefore many researchers suggest that financial reporting quality is affected by choice of accounting policies. Most of the empirical studies have been conducted in listed companies that are open to the market information as opposed to commercial state corporations that may lack incentives to manage earnings due to concentrated ownership by the state. Thus sub hypothesis three, *discretionary accounting choices have no significant relationship with earnings management quality was then tested*. The Pearson’s moment correlation results on the relationship between discretionary accounting policies and earnings quality showed  $r=0.051$ ,  $p=0.441$ , the implication of the result was that discretionary accounting choices showed no significant relationship. And the results of OLS also showed no significant effect on earnings quality. This is shown in Table 3c below. The R-squared = 0.003 and adjusted  $R^2 = -0.002$  is insignificant in explaining any variation in earnings quality in commercial state corporations. Hence, the null hypothesis 3c was confirmed.

Table-3c. Regression results of the relationship between discretionary accounting choices and earnings quality.

Model	R	R square	Adjusted R square	Std. Error of the estimate	F	Sig.
1	.051	0.003	-0.002	3.2227229	0.596	0.441

The effect of timeliness in reporting of annual financial information has been discussed in the empirical literature as one of the qualities of good accounting information. Not much has been done to confirm the relationship between discretionary accounting choices and timeliness in reporting. Commercial state corporations take longer durations before the annual statements are published. This argument inform the sub hypothesis thus: *Discretionary accounting choices have no significant relationship with timeliness reporting quality*.

The Pearson correlation results between discretionary accounting policies and timeliness reporting quality showed no significant relationship but have negative correlations ( $r=-0.113$ ,  $p=0.08$ ). The regression analysis also confirms that there is no significant effect between the two study variables. The results of the regression are shown in Table 3d:

**Table-3d.** Regression results of the relationship between discretionary accounting choices and timeliness reporting quality.

Model	R	R square	Adjusted R square	Std. Error of the estimate	F	Sig.
1	.113a	0.013	0.009	5.06E+00	3.096	0.080

Thus Hypothesis three is confirmed since the findings showed no significant effect between discretionary accounting choices (accounting policies) with timeliness reporting quality.

The researcher further sought to establish the influence of discretionary accounting choices on the relationship between demographic diversity of TMTs and financial reporting quality. The hypothesis was then formulated within the stated objective. *The relationship between demographic diversity of top management team and financial reporting quality is not mediated by discretionary accounting choices.*

In order to test the hypothesis, the researcher first sought to probe the intervening role played by discretionary accounting choices through the use of Stepwise Multivariate Analysis. In order to establish the mediation effect, the [Baron and Kenny \(1986\)](#) was used.

The two measures of FRQ namely, disclosure quality and earnings quality do not meet first and second condition that is required for mediating effect as shown in hypothesis one, two and three. Therefore, only two measures namely ; fundamental qualitative characteristics and timeliness reporting are tested for the mediating effect on discretionary accounting choices between the relationship of demographic diversity and financial reporting quality. Hypothesis four is therefore only sub- divided into two sub hypotheses and results shown in [Table 4a](#) and [4b](#):

**Table-4a (i).** Regression results of the mediating effect of discretionary accounting choices and fundamental qualitative characteristics.

Model		Unstandardized coefficients		Standardized coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.020	.273		7.398	.000
	Age	.498	.180	.173	2.760	.006
	Tenure	.394	.165	.146	2.386	.018
	Gender	-.476	.213	-.138	-2.235	.026
	Education	-.567	.222	-.162	-2.548	.011
	FBG	.991	.258	.241	3.835	.000

**Table-4a (ii).** Regression results of the mediating effect of discretionary accounting choices and fundamental qualitative characteristics.

Model		Unstandardized coefficients		Standardized coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.767	.082		9.350	.000
	Age	.031	.059	.034	.517	.605
	Tenure	.029	.054	.035	.548	.584
	Gender	-.109	.069	-.100	-1.576	.116
	Education	.162	.072	.153	2.269	.024
	FBG	-.340	.082	-.275	-4.140	.000

**Table-4a (iii).** Regression results of the mediating effect of discretionary accounting choices and fundamental qualitative characteristics.

Model		Unstandardized coefficients		Standardized coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.063	0.276		7.474	0
	Tenure	0.391	0.167	0.145	2.341	0.02
	Gender	-0.573	0.213	-0.166	-2.694	0.008
	Education	-0.45	0.222	-0.129	-2.032	0.043
	FBG	1.018	0.262	0.247	3.89	0
2	(Constant)	1.929	0.297		6.49	0
	Tenure	0.363	0.169	0.134	2.152	0.032
	Gender	-0.558	0.213	-0.162	-2.624	0.009
	Education	-0.548	0.235	-0.157	-2.327	0.021
	FBG	1.06	0.264	0.258	4.02	0
	ACPL	0.319	0.263	0.08	1.215	0.225

The results of the findings in Table 4a (i) to (iii) shows that there is no mediation effect with discretionary accounting choices. The first two steps are fulfilled in Table 4 (i)-(ii). The result shows no intervening effect in Table 4(iii). The B= 0.08 t= 1.215 at p=0.225. We therefore conclude there is no mediating effect; hence, the hypothesis H04a is confirmed.

**Table-4b (i).** Regression results of the mediating effect of discretionary accounting choices and timeliness reporting quality (Step One).

		Coefficients				
Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	13.537	1.985		6.820	.000
	Age	2.635	1.430	.120	1.842	.067
	Tenure	-4.863	1.300	-.239	-3.741	.000
	Gender	.604	1.678	.023	.360	.719
	Education	-.617	1.733	-.024	-.356	.722
	FBG	2.421	1.986	.082	1.219	.224

The findings reveal no mediating role from Table 4b (i) in the first step of the test. There is no significant results with coefficients of age, tenure, gender, education and functional background (FBG) B= 0.120, -.0239, 0.023,-0.024 and 0.082, t=1.842, -3.741, 0.360, -0.356 and 1.219 with p = 0.067, .000, 0.719, 0.722 and 0.224. The hypothesis is therefore rejected since the four steps of Baron and Kenny is not fulfilled.

**Table-4b (ii).** Influence of discretionary accounting choices on demographic diversity of TMT and financial reporting quality (Step Two).

Model		Sum of squares	Df	Mean square	F	Sig.
1	Regression	.036	2	.018	.396	.673 <sup>a</sup>
	Residual	10.702	237	.045		
	Total	10.737	239			

The findings reveal that discretionary accounting choices on depreciation and inventory costing methods have insignificance influence on the relationship between demographic diversity of top management team and quality reporting. Therefore, the hypothesis is confirmed.

#### 4. Discussions

It is evident from empirical literature that discretionary accounting policies have positive impact on earnings quality management. However, the current study failed to show any relationship between discretionary accounting choices based on (revenue recognition, depreciation on fixed assets, valuation of inventory and expenses on bad debts and contingent liabilities) and financial reporting quality measured under the four distinct measures. The only issue or alternative to these contradictions in findings is lack of autonomy in operations of the commercial state corporations. This may be supported by Bergstresser and Philippon (2006) who found out that, the use of discretionary accounting Policies in commercial enterprises in general is more pronounced where top management team potential total compensation is more closely tied to the value of stock and option holdings. This option is lacking in almost all the commercial state corporations. Most of the top management lack the motivation and will to make discretionary accounting choices that enhance the value of the firm.

The composition of TMTs becomes critical in enhancing financial reporting quality in commercial entities. This has been a missing out policy and practice in commercial state corporations. The understandings from theoretical and empirical research work is that individual specific characteristics have impact on financial reporting quality, although most of the studies reviewed only present the effect of demographic diversity on individual CEOs, CFOs, BoDs and audit committee on financial reporting quality measured by earnings management and audit quality. This gap has been bridged by having the current study looking at the effect of demographic diversity on TMTs (which is a composition of CEOs, CFOs, internal Auditor and members of the audit committee as operationalized in chapter three) on disclosure quality, fundamental qualitative characteristics, earnings quality and timeliness in reporting. The study sets good precedence on enhancing governance towards high quality reporting in commercial state corporations in Kenya. One of the most challenges to modern managers, administrators and stakeholders of modern companies today is an establishment of an optimal mix within the TMTs, BoDs and audit committee in terms of gender, age, race, education, functional background and culture. Although much has been written and even legalized in the constitution of Kenya (the current new constitution in Kenya 2010), little has been done to find out the best demographic diversity composition on TMTs for commercial state corporations which can create value for



money for the entire stakeholders in the public sector. The stakeholder theory in the public sector tend to be weak or is not properly applied to enhance value creation by motivating stakeholders of CSCs demand high financial reporting quality. None of the empirical studies are available in the CSCs in Kenya.

Financial reporting quality is very important for the stakeholders in reducing information asymmetry between the management and the stakeholders. The reduction of the vital information increased financial reporting quality in the reporting companies. The importance of this is revealed in the current study findings that most TMTs provide corporate voluntary disclosure at will to their stakeholder. However, most of the empirical studies reviewed have much concentrated on the listed companies, hence, not much has been given on how long commercial state corporations in Kenya take to publish their statement. This makes the current study unique with other studies listed companies in the stock exchange. In Kenya for example, listed commercial state corporations takes an average of ninety (90) day to release annual financial statements after each year end. From the findings of the study, though not a comparative study, the findings is contrary to commercial state corporations not listed, which takes an average of 203.78 days or more to release the annual statement to the general public. What happens to this information that is held for these periods? This gap has been bridged by using timeliness reporting as a proxy of FRQ. The indicators have shown how long the financial reporting takes long. It shows how potentials of the commercial state corporations are destroyed and how inefficient the information is released to the potential investors.

The findings seem to go against the theoretical and empirical understandings. The theoretical understandings is that discretionary accounting choices are indirectly or direct associated with earnings management, disclosure quality and the nature of information expected from the annual reports. [Smith and Watts \(1992\)](#) find that inventory write downs, write off of receivables and depreciation methods used on fixed assets potentially lower earnings reported. [Guay, Kothari, and Watts \(1996\)](#) uses discretionary accounting choices to explain the quality of earnings forecast in listed companies. However, the context of the current study is different, but still the results raise questions why no relationship. The findings indicate that the five Policies used in the study only account for 29.6% variations.

The theoretical understandings on the relationship between discretionary accounting choices is that the existence of pressure from shareholders, bondholders and regulators have greater influence on the choices made by TMTs. [Healey 2005](#) argues that the choice of accounting Policies to use result from pressure of compensation, debt contract and political expectations. With freedom in accounting choices of policies and increase in information asymmetry there is need to enhance monitoring ([Jensen & Meckling, 1976](#)). However, it is not clear whether the freedom of choice may be influence by other factors other than top management.

[Ling \(2012\)](#) finds that individual managers characteristics significantly influence accounting choices over time. His findings are consistent with the current findings where education, tenure and functional background of the TMT in commercial State Corporation significantly affect discretionary accounting policies. [Helson \(1998\)](#) finds significant relationship between discretionary accounting choices and earnings quality management and disclosure quality. [Hribar and Yang \(2010\)](#) find significant relationship between demographic characteristics of TMTs and accounting choices. [Davidson, Xie, Xu, and Ning \(2007\)](#) examined the relationship of top management age and functional career background on earnings quality. The findings showed that older managers are rarely associated with aggressive accounting policies that would increase earnings. All these studies point to a relationship between TMT characteristics and FRQ (earnings management), relationship between accounting Policies to FRQ (earnings management). Therefore the formulation of the hypothesis was informed by the literature. However, no literature linked of the literature to the other proxies for FRQ (disclosure quality, timeliness and fundamental characteristics).

The literature has provided alternatives to why other measures namely; disclosure quality, timeliness and fundamental qualitative characteristics are not popular in literature. [Beneish \(2001\)](#) argues that most studies prefer using earnings quality as proxy FRQ because it is easier to determine firms value from earnings. [Jiang, Lee, and Anandarajan \(2008\)](#) note that accounting earnings are the most widely used measures of FRQ, given that accounting rules and standards provide TMTs of firms with considerable opportunities for earnings management. Hence much attention has been devoted to earnings management. While [Matsunaga and Yeung \(2008\)](#) put it clear that FRQ depends on Managerial motives and characteristics, Hence the most appropriate measure is earnings management.

Therefore the conclusion is that discretionary accounting choices do not mediate the relationship between demographic diversity and FRQ in commercial state corporations in Kenya. The failure of the mediation may be attributed to mode of measurement of the variables. The use of dummy variable result into sidelining one effect of the variable. The second reason would be the accounting Policies used were limited to five, and currently the level of discretion by the management might have been reduced through the adoption of international accounting standards in line with [FASB \(2008\)](#).

## **5. Recommendations**

This study lays a broad foundation for the future research work into the theory and practice of financial reporting quality in commercial state corporations in Kenya. The main objective of the study was to investigate the effect of demographic diversity of top management team, discretionary accounting choices on

financial reporting quality in commercial state corporations in Kenya. The study findings clearly reveal that, there exist both positive and negative relationship between discretionary accounting choices and financial reporting quality. The relationship varies with each financial reporting quality proxy measures. However, the demographic variables that were statistically significant in explaining FRQ were; age, education, tenure, gender and functional background diversity. Hence, managerial characteristics matter in explaining discretionary accounting choices and financial reporting quality in the listed companies in the stocks exchanges, we provide Novell findings on how demographic diversity of TMTs in commercial state corporations in Kenya influence financial reporting quality.

The study finally recommends that future research could measure quality reporting using other indices of reporting quality and tracking specific fixed effect of top management team over time, since top executives background is an actionable variable for corporate board, better understandings of top management role is crucial for financial quality reporting. Discretionary accounting choices should not be used by the management opportunistically but should be used to enhance quality reporting. At the same time, the results can further help researcher explore the role of team members in explaining financial reporting quality and control the for top executives level characteristics when determining discretionary accounting choices.

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