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MODERATING EFFECT OF FINANCIAL REPORTING ON THE RELATIONSHIP BETWEEN GOVERNANCE AND NG-CDFs PERFORMANCE IN KENYA

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Abstract: **The performance of National Government Constituencies Development Funds (NG-CDFs) is key in the provision of services to citizens. However empirical literature suggests that their performance has not been satisfactory. This therefore prompted further inquiry on how financial reporting plays a role in the relationship between governance and performance of NG-CDFs. A census survey was carried out on all the 290 NG-CDFs performance in Kenya. A positivistic research philosophy and a descriptive cross-sectional survey design were used. Data was collected using structured and unstructured questionnaire. The questionnaire was administered through a drop and pick method. Regression analysis was then used to test the hypotheses at 95 percent confidence level. The results of the study findings were established and compared to various theories anchoring the study and conceptual, contextual and empirical evidence. Financial reporting as a moderating variable had a significant influence on the relationship between governance and NG-CDFs performance. The study made contributions to policy formulation, managerial practice and theory. The study benefits policy makers and managerial practise in both public and private sector. At policy level the unnecessary bureaucracy common in the governance of public sector needs to be looked at to reduce its negative relationship between governance and performance. Further, formulators of policy in the NG-CDF regarding governance and financial reporting can benefit from the findings of this study. Managerial practitioners especially in NG-CDF may consider strengthening governance interaction and combination with the other variables of the study to enhance performance. The study can also be used in different contexts in order for researchers to draw different patterns showing the effect of governance on organisational performance outcome.**

Keywords: **Financial Reporting, Governance, NG-CDFs, Performance.**

1. INTRODUCTION

The relationship between governance and performance is significant in devising efficient corporate management and public regulatory policies. Governance plays a crucial function in improving the performance of an organization, and there is a direct relationship between governance and performance (Beiner & Scmid, 2005). Better governance is likely to improve the performance of business entities, through more efficient management, better asset allocation, better labour practices, or similar other efficiency improvements. Governance is responsible for the installation of internal structures and techniques for decision making, accountability, control and behaviour in an organization (Armstrong et al., 2005).

However, governance alone cannot satisfactorily account for organizational performance. Other variables are critical to intervene or moderate the relationship between governance and organizational performance. Such variables could be financial reporting among others. Credible financial reporting aids stakeholders particularly the creditors in making informed lending decisions whether to lend or not. Governance also provides high quality accounting information and plays a crucial role in ensuring credible financial reporting (Habib & Azin, 2008). In case of extension of credit facility, the entity is able to operate optimally thus enhancing performance.This study was anchored on stakeholder theory which explains how stakeholders influence the financial reporting of an organization, structure and financial policy (Freeman, 1984).

NG-CDF is a government body formed by the Act of parliament in 2003 and amended in 2007, 2015 and 2016 to bring about socio-economic development at constituency level through financing locally prioritized projects and enhance community participation. However, there has been public outcry due to massive financial scandals, fraud, corruption and poor performance by NG- CDFs (Government of Kenya Economic Development Report May 2016). Some projects have been completed while others stalled due to poor governance. Some projects have stalled as an outcome of change of leaders, where the new Member of Parliament (MP) is not willing to continue with his or her predecessor's ideas. Besides stalled projects, funds have been embezzled through ghost projects – implying it has been stolen or through shoddy work. Okungu (2008) contends that 70% of the constituencies have reported mismanagement, theft, fraud and misappropriation, and that NG-CDFs issues are mostly political in nature. Ongoya and Lumallas, (2005) posit that, NG- CDFs have the ability of being used by politicians for political mileage to their constituencies to mobilize political support.

Various studies have been done on governance and NG-CDFs performance (Malala & Ndolo, 2014) with outcome which are inconclusive. This study sought to establish the connection among governance, internal audit, financial reporting and performance of National Government Constituencies Development Funds (NG-CDFs) in Kenya.

This research study was motivated by the fact that NG-CDFs are very important in the sense that they accord individuals at the grassroots the privilege to make expenditure decisions that maximize their welfare in accordance with their need of education and security services hence promoting economic growth. Further, NG-CDFs provide sustainable development to all parts of the republic compliant to article 10(2) (d) of the constitution of Kenya 2010 thus contributing to the success of the Kenya Vision 2030,agenda four and accommodate peoples' participation in the determination; implementation of earmarked national government development projects at the constituency level. Finally, NG-CDFs promote national values of human dignity, equity, social justice, equality human rights, non-discrimination and care for the marginalized.

2. STATEMENT OF THE PROBLEM

Currently Governance is major debate in the world due to the numerous corporate financial scandals and the ensuing business failures that include the Asian financial crisis of the late 1990s, Enron, WorldCom, Global Crossing and Tyco in the USA and Vivendi, Parmalat and others in Europe. These scandals have called into question the honesty and integrity among Corporate Boards and Executive Management (KPMG, 2004).

Many state corporations and private companies such as National Cereals and produce board, Kenya pipe line company, Standard Gauge Railway, Mumias sugar company, Uchumi super market, Kenya Airwaya, National Social Security Fund, Chase bank, Imperial bank just but to mention a few realised declining revenue while others closed shop due to poor governance, fraud and corruption (Capital Market Authority,2018).World.com and Enron scandals led to strengthening corporate governance structures mainly internal audit and audit committee. The major financial scandals and other inefficiencies were caused by weak internal audit, poor internal control systems and weak corporate governance which the Sarbanes Oxley Act of 2002, tried to address. Organizational resources have an influence on firm performance (Pearce et al., 2012) which enhances organizational performance. Financial reporting has a great influence on governance in terms of management of information disclosure in annual reports (Gibbins et al., 1990).

However, there has been public outcry due to massive financial scandals, fraud, corruption and poor performance by NG-CDFs (Government of Kenya Economic Development Report May 2016). Some projects have been completed while others stalled due to poor governance. There is a widespread misuse of funds in the NG- CDFs. Members of Parliament (MPs) either misused or took the money. Some projects have stalled as an outcome of change of leaders, where the new MP is not willing to continue with his or her predecessor's ideas. Besides stalled projects, funds have been embezzled through ghost projects – implying it has been stolen or through shoddy work.

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Several studies (Tariq and Abbas 2013, Kalezic et al., 2012) have been carried out and they provide empirical evidence on governance and organizational performance. However, there are conceptual, contextual, methodological and theoretical gaps. Conceptually the empirical assessment of the relationship between governance, internal audit, financial reporting and organizational performance has yet to provide the connection among the four variables. Many of the studies have mostly addressed the association between governance and organizational performance. Outcomes of these studies are conflicting while some studies found out that good governance enhance performance (Tsamenyi et al., 2007) others found that governance had a negative linkage between governance and organizational performance (Guenster & Otten, 2004; Price et al., 2011).This study therefore was a trial in addressing these gaps by answering the questions, what is the effect of financial reporting on the relationship between governance and NG-CDFs performance in Kenya?

3. OBJECTIVE OF THE STUDY

The main objective of this study was to establish the effect of financial reporting on the relationship between governance and NG-CDFs performance in Kenya.

4. LITERATURE REVIEW

Some research studies have established positive relationship between governance and organizational performance (Rashid et al., 2008) while others have found negative relationship. Nevertheless, Beiner and Schmid (2005) assert that governance plays a critical role in the improvement of performance in an organization hence there is a direct relationship between governance and performance. Good governance reduces management compensation and the resources saved are used in revenue generating activities thus boosts organizational performance.

Tariq and Abbas (2013) studied the relationship between corporate governance practices and firm performance among 119 listed firms from 2003 to 2010 using multidimensional performance framework. Their findings were that there is a significant impact of compliance on firm performance that is good corporate governance practices impact positively on firm performance. The above research work illustrated the relationship between governance and organizational performance. However, the study did not study the effect of internal audit and financial reporting as intervening and moderating variables respectively on the relationship between governance and firm performance. An aspect that would have improved the study was if it considered the effect of internal audit financial reporting as intervening and moderating variables on the relationship between governance and firm performance as well as use DEA to measure organizational performance.

Financial reporting is a moderating variable in the study. It is different from governance because it is under strict supervision of audit committee (Levitt, 1999). Tabar and Ungurea (2012) state that audit committees are nominated to be in charge among other functions in overseeing financial reporting process, including the peril and similar controls. Therefore, financial reporting information, that is financial statements are reviewed by audit committee before being submitted to the board for scrutiny particularly among the key issues such as significant adjustments arising on the audit, subject them to independent appraisal and ensure that they have been prepared complying with accounting standards, disclosure and legal requirement (Sarbanes Oxley Act,2002).

According to Bibbins et al, (1990) timeliness of financial reporting influences corporate governance particularly the board of directors who manage information disclosure in the annual reports such that they release financial information on time. When the financial reports are released on time, both the external and internal users gain confidence with the board and the management. The confidence attracts stakeholders who bring their resources to the organization which finances various income generating activities hence improves performance. This is supported by international accounting standards (2010) which state that the objective of financial reporting is to provide useful information about investors, lenders and other creditors in decision making about providing resources to the entity.

Adekule and Taiwo (2013) carried out a study to examine financial reporting among post consolidation banks in Nigeria and the consequent stability of the banks. Sample size was the 21 banks quoted at the Nigerian Stock Exchange between 2005 to 2009.Data was collected using secondary data through in-depth content analysis of published annual reports accounts. The key findings of the study were in compliance with mandatory disclosure were at high level as requirements for banks scoring high on the CDI (mean in excess of 90%). Secondary, the regression analysis results indicated that disclosure has a positive and major influence on banks stability. In spite of the high compliance with the existing regulatory requirements, the banks' exposure to internal weakness and subsequent distress were not removed. The authors argued that the existing mandatory information disclosure needs were insufficient and required to be enhanced.

Mironiuc et al. (2015) investigated the value relevance of the comprehensive income in relation to that of net income as a consequence of usage of international financial reporting standards (IFRS) in Romania using a sample of sixty five companies quoted in the Bucharest Stock bourse in the period 2011 to 2012. They analyzed the influence of the big four companies in terms of the net income and the comprehensive income for the investors on the financial market and the quality of audit being witnessed. The study found out that the two segments of accounting results are associated with an increase value relevance and usefulness for the investors on the Romanian financial market.

Hastuti et al. (2016) examined the effect of international financial reporting standards (IFRS) based accounting standards on the actual earning management (REM) moderated by internal control structure. The sample of the study was the manufacturing companies listed in the Indonesia Stock Market from 2010 – 2014 using a non-probabilistic sampling. The findings were that adoption of IFRS-based accounting norm had a positive effect on the REM and good corporate governance proxied by internal control structure weakens the positive effect on the IFRS – based accounting standard adoption on REM. The study was informative. However, it has these weaknesses; first, the study never stated the population size of the manufacturing companies at the Indonesia stock exchange in the period indicated.

5. RESEARCH METHODOLOGY

This study thus adopted cross-sectional survey design which is a social survey structured research or structured observation on a sample at a single point in time (Bryman & Bell, 2011). This exploratory survey design is ideal for this study since it has clearly stated hypotheses or investigative questions (Cooper & Schindler, 2006).It was also suited for the study because NG-CDFs in Kenya are spread in all parts of the country.

The target population comprised all the constituencies in Kenya that is the two hundred and ninety NG-CDFs in Kenya and the unit of analysis was NG-CDFs management. Therefore, the study was a census of the 290 NG-CDFs in Kenya as per NG-CDFs Act (2016) since the NG-CDFs are few but spread in the entire country, Kenya. Either the chairperson or the secretary or the treasurer or the Fund accounts manager or a registered voter answered the questions.The research study used both primary and secondary methods of data collection because both data reinforce each other (Cooper & Schindler, 2006, Saunders et al; 2007). Primary data was collected by self-administered, pre-arranged questionnaire. The main source of secondary data was reports on evaluation.

Data collected was cleaned, edited, validated, coded and checked for any coding errors and omissions. Thereafter it was run through the statistical package for social sciences (SPSS) Version 22 and analysed through descriptive and inferential statistics adopting Sekaran (2004). . Data was analysed by use of descriptive statistics such as mean scores, standard deviation, frequencies and percentages and correlation coefficient for likert scale variables in the questionnaire covered all the reaction variables and provided impetus for further analysis (Mugenda & Mugenda, 2003).Data was presented in form of tables. The relationships between variables was investigated through hypothesis testing using quantitative techniques specifically Pearson's product moment correlation coefficient. The performance of NG-CDFs was measured using DEA model specified by Charnes et al, (1978) on target population.

6. RESEARCH FINDINGS AND DISCUSSIONS

Moderating influence of Financial Reporting on the relationship between Governance and Performance of NG-CDFs in Kenya

The following hypothesis was tested. *H_1: the relationship between governance and performance of NG-CDFs in Kenya is not significantly moderated by financial reporting.* The hypothesis was tested through Stepwise regression analysis. In step one; governance was regressed on NG-CDFs performance. In step two, governance was regressed on financial reporting. In step three the interaction term between governance and financial reporting was introduced. The moderation effect is confirmed when the effect of interaction term is statistically significant.

Table 1: Moderation Results of Financial Reporting on Governance and NG-CDFs Performance

Model Summary

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
						R Square Change	F Change	df1	df2	Sig. F Change
1	Governace	.442[a]	.196	.193	.17385	.196	63.970	1	263	.000
2	Governance, Financial reporting	.843[a]	.711	.710	.63549	.711	645.823	1	263	.000
3	Governance, Financial reporting interaction	.399[a]	.159	.156	.17715	.159	50.141	1	265	.000

ANOVA

Model			Sum of Squares	Df	Mean Square	F	Sig.
1	Governance	Regression	1.933	1	1.933	63.970	.000[b]
		Residual	7.949	263	.030		
		Total	9.882	264			
2	Governance, Financial reporting	Regression	260.812	1	260.812	645.823	.000[b]
		Residual	106.211	263	.404		
		Total	367.023	264			
3	Governance, Financial reporting interaction	Regression	1.573	1	1.573	50.141	.000[b]
		Residual	8.316	265	.031		
		Total	9.889	266			

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		β	Std. Error	Beta	T	Sig.	Tolerance	VIF
1	(Constant)	.292	.016		18.006	.000		
	Governance	.056	.007	.442	7.998	.000	1.000	1.000
	(constant)	.295	.059		4.975	.000		
2	Governance, Financial reporting	.650	.026	.843	25.413	.000	1.000	1.000
	(constant)	.276	.019		14.268	.000		
3	Governance, Financial reporting interaction	.060	.008	.399	7.081	.000	1.000	1.000

The result in Table 1 was computed using three steps. In model one the result shows that the association between governance and NG-CDFs performance was moderate and significant (R=.442[a,] R^2=0.196, F=63.970, P-value<0.05). In model two (R= .843[a,] R^2=.711, F=645.823, P-value<0.05) which was strong and significant and in model three (R= .399[a,] R^2=0.159, F=50.141, P-value<0.05) which is strong and significant, suggesting a moderating effect in model three after an interaction term is introduced.

The value of the interaction term (GOVFR) had a significant influence (β= .060, t=7.081, P<0.05) thus confirming a moderation effect of financial reporting therefore supports the hypothesis that financial reporting has a significant moderating influence on the relationship between governance and performance of NG-CDFs in Kenya. This was guided by the following model; $Y= \alpha+ \beta_1 X+ \beta_2 Z+\beta_3 X.Z + \varepsilon$

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Where: Y_i is NG-CDFs performance

X is Governance

Z is Financial reporting (Moderating variable)

X.Z is governance and financial reporting (interaction)

ε= Error term

β = the beta coefficients of independent variables after the regression analysis results, the model became Y= .276 + $.292X_1$ + .650Z+ .060XZ.

The model implies that NG-CDF performance represents .276 units in absence of governance and financial reporting. However when governance, financial reporting and interaction term are added each contribute 0.292(29.2%), 0.650 (65.0%) and 0.060 (6.0%) respectively. This implies that financial reporting contributes significantly in the relationship between governance and NG-CDFs performance.

Performance of NG-CDFs in Kenya

Data envelopment analysis was used to examine performance of NG-CDFs in Kenya using input/output relationship. DEA is a non-parametric linear programming technique that computes a comparative ratio of outputs to inputs for each unit, which is reported as the relative efficiency score. The efficiency score is usually expressed as either a number between 0±1 or 0±100%. A decision-making unit with a score less than 100% is deemed inefficient relative to other units. In this study, DEA was used to measure the technical efficiency (TE) of DMUs as shown in table 2.

Table 2: Performance of NG-CDFs in Kenya

Range/Statistic	Frequency	Value
0.0 to 0.3	102	38.20%
0.31 to 0.6	124	46.44%
0.61 to 0.9	39	14.61%
0.91-1	2	0.75%
Mean		0.389278
Standard Error		0.0118
Median		0.357503
Mode		0.504587
Standard Deviation		0.192815
Sample Variance		0.037178
Kurtosis		0.053153
Skewness		0.647806
Range		0.93745
Minimum		0.06255
Maximum		1
Sum		103.9372
Count		267
Confidence Level (95.0%)		0.023233

Efficiency is defined as the ratio of outputs to the resources used/inputs. In this study, DEA Model inputs were: budget allocations, projects proposed, operational costs incurred and employee remunerations. The outputs were projects completed projects efficiency, employee efficiency and operational efficiency.

The findings shown in table 2 indicates that majority (46.44%) of NG-CDFs were moderately inefficient with efficiency score of between 0.31 and 0.6. It was also established that 38.2% of NG-CDFs were inefficient with efficiency score of 0.3 and below. Further findings indicate that the performance of 14.61% of NG-CDFs was above average with efficiency score ranging from 0.61 and 0.9. Only 2 NG-CDFs representing 0.75% were found to be efficient with efficiency score of 1. The mean efficiency score was 0.389278 which is below average. In order to increase efficiency, NG-CDFs should decrease the level of resources and investments and/or increase the production factors.

7. CONCLUSION AND RECOMMENDATION

The study established that there was moderating effect of financial reporting on the relationship between governance and performance of NG-CDFs in Kenya. The result was positive and significant. The hypothesis on this concept relationship was also tested. The results showed that financial reporting moderated the relationship between governance and performance of NG-CDFs in Kenya. Therefore, the linkage between financial reporting and performance of NG-CDFs cannot be ignored.

The study's conceptual model was tested and retained due to the empirical evidence. The model suggests that performance of NG-CDFs is influenced by more than one variable thus validating the main objective of this study that the association among governance and financial reporting influence performance of NG-CDFs in Kenya. The study has several inferences to theory, managerial practice and policy. The successive sections present those inferences. The study findings demonstrate that the introduction of financial reporting yielded stronger explanatory power of the connection between governance and performance of NG-CDFs in Kenya will arouse deeper academic discourse and form a basis of strengthening, policy and managerial practices in performance of NG-CDFs in Kenya.

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