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Original Research Article

Demographic Diversity in Top Management Team and Financial Reporting Quality in Commercial State Corporations in Kenya

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The purpose of the paper is to examine the effect of demographic diversity in Top Management Team (TMT) on financial reporting quality in commercial state corporations. The study adopted correlational and longitudinal research design and stepwise regression analysis of FRQ variables on a set of demographic diversity variables in TMT. The findings provide considerable evidence to suggest that TMT demographic diversity are associated with financial reporting quality measured by fundamental qualitative characteristics of accounting information, earnings management, timeliness in reporting and disclosure quality. The research implication is that; in general, demographic diversity in TMT- gender, age, education, tenure and functional background may have important implication for financial reporting quality under different measures. The value of this paper is to extend Prior research by addressing the potential effects of TMT demographic diversity on FRQ. The findings reported in this paper provide novel insight to empirical financial reporting quality literature in commercial state corporations.

Keywords: Financial Reporting Quality, Demographic Diversity, Top Management Team, Commercial State Corporations.

INTRODUCTION

The primary objective of financial reporting is to provide high quality financial information concerning the economic activities of entities useful for economic decision making. It is not surprising that there is increasing attention by management and accounting scholars to persistently search for specific determinants of financial reporting quality (FRQ) in the wake of a number of financial scandals of early 2000s (Cheng et al., 2010; Fracois and Kyle 2011; Ge et al., 2011). Going by this postulation, companies today are increasingly under pressure to provide accurate and reliable information faster and more efficiently.

However, not much consensus has been achieved on how top management team diversity affects financial reporting quality since other factors such as management integrity, incentives, accounting choices, local regulations, international standard settings and supervision mechanisms have been suggested to affect FRQ of firms. Hambrick and Manson

(1984) used upper echelons theory to explain how demographic diversity of top management teams (TMTs) influence firm's outcomes. This puts the behaviour and personal characteristics of TMTs as potential determinants of financial reporting quality, given that managers have some discretion in which information they want disclosed and withheld. In this paper, we examine the relationship between demographic diversity of TMT and FRQ. In particular the paper focuses on TMT demographic diversity of CEOs, CFOs and audit committee members.

Managers' demographic diversity in gender, tenure, education, age and functional background are some of the characteristics perceived to influence the quality of accounting information. The effects of TMT dynamism in management and decision making in accounting and finance can be explained by the upper echelons theory (Hambrick and Manson, 1984).

The origin of state commercial corporations in Kenya, according to sessional paper of 1965 can be traced back to 1963 when Kenya attained political independence. The establishment of the state commercial enterprises in Kenya was driven by a number of objectives such as; desire to accelerate economic, social development, redress economic imbalances and promote foreign investments. In Kenya, Government Owned Enterprises (GOEs) are established to play several roles, namely; accelerate economic growth and development; improve the delivery of public services, create employment and build international partnership. The available data on GOEs shows that the output of state corporations to GDP in nominal terms increased from 9.54% in 2009/2010 to 11.64% in 2010/ 2011 based on internally generated revenue. As a way of improving the financial management and reporting quality, PTPR, 2013 have reclassified Kenyan state corporations into five distinct classes; commercial state corporations, commercial state corporations with strategic roles; executive agencies, independent regulatory agencies and research institutions, public universities, tertiary education and training institutions.

A commercial state corporation is defined as an entity incorporated, solely or majority owned by the government or its agents for commercial purposes. Or corporate body established by the Act of parliament, licensed under banking Act or incorporated under company Act, of Kenya, formed to meet commercial goals (PTPR 2013; OECD 2005a:36; Wamalwa 2003). The commercial state corporations can further be categorized as state commercial with strategic functions or commercial state corporations. The term commercial state corporations will be used in the study to refer to the two groups of commercial corporations in Kenya.

The commercial state corporations (CSCs) are distinguished from the rest of the government owned enterprises (GOEs) since their revenues come from the sales of goods and services and pursue financial objectives with returns on their investment. They are answerable to the respective parent ministries under which they fall and the state control may be determined by shareholders rights and established regulatory bodies. The CSCs have been selected for this study for a number of reasons; first, their enormous role in economic development in Kenya.

Secondly, they are characterized by low enforcement of standards, incentives for manipulation of financial statements, high political influence, unstable financial markets and poor governance standards. Thirdly, there is a growing public interest in earnings, accountability, efficiency and investment interests in the CSCs. Fourthly, most CSCs are performing poorly and a number of them are currently earmarked for privatization and restructuring and finally, most of the empirical studies on financial reporting quality have concentrated on the listed companies, hence CSCs is well suited for this study.

Financial Reporting Quality

Financial reporting quality is a subtle concept in accounting literature, hence, there is no consensus so far among researchers on how best to define and measure it. McDermott (2011); Biddle et al., (2009); Nasser and Nuseibeh (2003); Robinson and Munter (2004) define financial reporting quality as the precision with which financial reporting conveys information about the firm's operations or compliance of accounting standards of a particular country, or the extent to which the published financial statements and related disclosures capture the essence of the operations and financial position of the reporting entity. However, IASB (2008) defines

FRQ in-terms of the fundamental and enhancing qualitative characteristics underlying decision usefulness. These definitions are consistent with the Financial Accounting Standard Board (FASB) since they are all concerned with the manner in which financial accounting information is presented to the stakeholders. In a broader perspective FRQ may be regarded as a rational approach of an individual user of financial statements since different user groups have dissimilar preferences, therefore perceived quality will deviate from each user group.

Financial reports play the main medium of communicating the information discrete to outside user. FASB (2008 p.13) states that, 'the objective of financial reporting is to provide financial information about the reporting entity that is useful to potential investors, lenders and other creditors in decision making, in their capacity as capital providers. Meyer (2007 p.2)' finds that accounting plays a significant role within the concept of generating and communicating the wealth of companies.' Biddle and Hillary (2006) and Lambert et al. (2007) suggest that financial reporting quality is determined from a number of perspectives namely; earning, persistence, timeliness, disclosure quality, audit fee charged, compliance with international financial reporting standards and earning management. These measures of FRQ only focus on attributes believed to influence quality of financial information, hence indirectly measure the level of FRQ. Going by literature on measures of financial reporting quality there is evidence that some models are not comprehensive measures of reporting quality. Vantendeloo & Vansstrealen (2005) argue that accrual models only use financial information; hence exclude non-financial information from annual reports of firms. This model has been used in most of the empirical studies dealing with FRQ.

IASB (2010 paragraph QC4) states that, 'if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of the financial information is enhanced if it is comparable, verifiable and understandable.' Previous studies have not provided the best measure (s) for FRQ despite a number of studies on this area, making it impossible to comprehensively assess the quality of financial statements. However, quality information means that information meets the requirements and specifications given to it, or exceeds the expectations of users (IASB 2008). Thus, FRQ depends on measurement used and objectives of financial reporting.

The aforementioned studies confirm that financial statements still remain the most important source of externally feasible information on companies. Nevertheless, in the wave of recent scandals and loss of billions of shillings of investments in state corporations in Kenya, the very integrity and representation of value relevance, timeliness in reporting and disclosure quality has been called to question. Hence, the need to determine the role of TMT in achieving quality financial reporting.

Demographic Diversity of Top Management Team

Harrison and Klein (2007) define diversity as separation, variability and disparity among unit members. Thus diversity as separation refers to differences in position or opinion among unit members reflecting values and attitudes. Diversity as a variability represent differences in kind or category, basically on information, knowledge, experience among unit members and finally diversity as disparity indicates differences in social assets of resources such as status. Jackson et al. (2003) define diversity in general as distributions of personal attribute

among interdependent members of work unit. The studies on diversity can be viewed in two perspectives; demographic diversity and cognitive diversity. The study adopts diversity to mean variability in demographic factors or characteristics of top management.

Demographic diversity includes variables such as gender, age, background, race, disability, religion, personality, work style among others and cognitive diversity includes variables such as education, tenure, functional and professional background (Hambrick & Mason 1984). Most research work on demographic diversity and its effects, focus on observable diversity such as age, gender and ethnicity in explaining the variability in the top management team. Building on the Upper echelons theory, Finkelstein et al (2008) and Hambrick and Manson (1984) point out that organizational outcomes and performance are reflections of attribute of senior management. The assertion here makes it critical to examine how these variables may be used to explain financial reporting quality in firms. In this study FRQ is seen as an organizational outcome determined by TMT characteristics. Recent studies in accounting research have relied on this theory to show how managerial effects have significant explanatory power for accounting choices and outcomes (Bamber et al 2010; Ge et al 2011). This study mainly focuses on demographic diversity as the variation of TMT in age, gender, education, tenure and functional background.

The definition of TMT in most studies of upper echelons have not been consistent (Finkelstein and Hambrick 1996). For example, Miller et al, (1998) define top management as a group of executives who report to the Chief Executive Officer (CEO) or a dominant coalition of individuals responsible for setting firm's direction and/or in charge of interpreting relevant information in the organization. Other scholars define TMT as top level management and board of directors (Mariamuthu and Indraa 2009). Since TMTs are highly ranking executives within the organization who make decisions that affect everyone in an organization or oversee the management process and are held responsible for the success or failure of an enterprise. It is very hard to determine the correct number of top management to be included. TMT is used in this study to refer to both top level management and board of directors involved in accounting work.

In order to investigate the effect of demographic diversity of top management team on FRQ, it is necessary to only consider a team of officers who are actually involved in preparation of accounting and financial statements or overseeing the financial management process in their firms. This argument is consistent with Roberto (2003) that, top management teams are comprised of a stable core and dynamic periphery that changes with the decision making situation. Carpenter, Galetkenyts and Sander (2004) further notes that the top management team size differs considerably over many studies and most studies do not report the size of the TMT as opposed to studies on the board of directors. The definition and size of top management is an important aspect of TMT composition that clearly has an impact on empirical findings of diversity studies. Given the above argument, this study will adopt top management team to include CEOs, CFOs, internal auditors and audit committee members from each corporation as they are the most key stakeholders involved in the preparation of financial statements and reporting decisions.

Financial reporting quality is a reflection of characteristics and action in a team of top managers central to firm's management where most researchers have identified managers' specific effects on accounting characteristics and firm's outcome in commercial enterprises. Although, this has

not been the case, in commercial state corporations in Kenya. Empirical studies on effect of both team and individual managers' characteristics diversity on financial reporting quality have much concentrated on the listed companies, with earnings quality as a measure of FRQ (Barua et al. 2010; Marimuthu and Indraa 2009; and Ling 2012). Financial reporting quality does not only mean earnings or stock price changes, but it is a multi-dimensional term that requires comprehensive measures of quality accounting information (IASB, 2008).

As cited in Outa (2011) two business indices used in Kenya in 2009; business indicator index (KIBII) ranked Kenya at 71 out of 100 countries with a score of 6.48 out of full score of 12. E-standards forum index ranked Kenya at 72 out of 100. These two indices clearly show that Kenya's compliance with IFRSs is quite low. The two measures are used to monitor a country's economic, financial and political performance so as to provide stakeholders with viable information for prudent decision making, although the two indices are too general in measuring FRQ. In order to be more specific, according to rating survey of public sector agencies and ministries in Kenya by PEFA assessment of 2008 and 2012 on accounting, recording, reporting quality and timeliness of annual financial statements, the rating remained very low with no changes over time. ROSC (2010) indicates lack of tangible studies in state commercial corporations but recognizes their significance to the public interest and economic development.

Local studies conducted in Kenya on FRQ and complexity is based on listed companies and commercial banks (Barako 2007; McFie 2009; Outa 2011; Mutiso and Kamau 2013). These studies have not considered the TMTs' characteristics as one of the determinant of FRQ. Researchers typically rely on firm level, industry level and market level characteristics to explain accounting practices and reporting and little consideration has been given to the effect of individual and TMT's characteristics.

The aforementioned local studies have not linked FRQ with the personal characteristics of the team of managers central to firm's management. The current study sought to bridge this knowledge and contextual gap by integrating the demographic diversity of TMTs and financial reporting quality on commercial state corporations in Kenya. Hence, the specific focus of the study was to establish the effect of demographic diversity of top management team on financial reporting quality in commercial state corporations in Kenya.

THEORETICAL FRAMEWORK AND RESEARCH HYPOTHESIS

The Upper Echelons Theory

Theoretically, the upper echelons theory was introduced by Hambrick and Mason (1984), with an intention of explaining how personality characteristics of top executives affect the performance of organizations. Their basic idea in upper echelons was to focus on characteristics of TMT rather than on individual top executive in order to inform better understanding of the organization outcomes. This sentiment is shared by Goel and Thakor (2008) who document that personality characteristics of top management influence their decisions.

Secondly, demographic profile of executives of TMTs is highly presumed to relate the organization performance outcomes. Group heterogeneity is manifested by diversity of personal background and leadership experiences.

The upper echelons theory states that organizational outcomes, strategic choices and performance levels are partially predicted by managerial background characteristics (Hambrick and Mason, 1984). The central idea and the core of this theory, is that, executives act on the basis of their personalized interpretations of the strategic situations they face, and this personalized construal is a function of the executives' experiences, values, and personalities (Hambrick 2007). Early empirical research on UET investigated the effects of top management team's heterogeneity in observable background characteristics, such as age, functional track, career experiences and education level on various organizational outcomes.

Upper echelons theory describes the role of individual factors and team processes on executive decision-making (Nielsen 2010). It blends with other theories such as; agency theory and positive accounting theory. Hence, a variety of theoretical perspectives can be applied together with upper echelons theory to explain the antecedents and consequences of top management demographic diversity on FRQ and discretionary accounting choices. Hambrick and Manson (1984) identify six specific observable characteristics (age, functional background, other career experiences, formal education, socio-economic status and financial position) that contribute to either an individual personal background or leadership experience considered sufficient for heterogeneity.

On the practical end, scholars focus on precise definition of TMTs. Most often the top management team is identified based on top executives' formal titles listed in publicly available documents or responses provided by the firm CEO in an interview (Finkelstein and Hambrick, 1996). However, Pitcher and Smith (2001) observed that actual decision making authority does not necessarily always lie in formal defined TMT. This inconsistency in the definition of TMTs may be a contributing factor in the inconsistency of the empirical results. Carpenter et al (2004) argue that TMT size differs considerably over studies. However, based on the structural features of TMTs can create paradoxical cognitive frames which may in turn work against the organization's outcomes. Hambrick and Manson (1984) distinguish two types of characteristics that influence the decisions taken by top executives: the psychological characteristics that are difficult to quantify and the observable characteristics. The current study focuses on the observable TMTs' characteristics.

Positive Accounting Theory

The positive accounting theory (PAT), developed by Watts and Zimmerman (1986), tries to explain and predict accounting practices. It is used in accounting studies to explain and predict firm choices on accounting practices. The theory hypothesizes that, in imperfect markets, accounting choice may be determined by managers seeking to influence reported earnings and capital structure (Watts and Zimmerman, 1986). The state commercial enterprises are perceived to be operating in an imperfect markets since they lack capital markets settings for raising funds. The theory is based on the ideas that, management is self interested, has information advantage and that there are conflict of interest between the principal and the agent. This self interest may be a function of management fixed effects and accounting choices. The PAT focuses on the relationship between the various individuals involved in providing resources to an organisations.

In making discretionary choices in accounting, conservatism continues to be found in financial reports despite FASB/ IASB considering it un-desirable quality of financial

reporting information (IASB 2008). Positive accounting theory is used in this study to explain management's motive for making accounting choices when markets are inefficient and accounting standard are not providing full direction on applicability.

Positive accounting theory, attempts to explain managers' choices of accounting methods in terms of self interests and the relationship between stakeholders. The assumption is that all individual' action is derived by self interest and that the individual will act in an opportunistic manner to the extent that, the action will influence quality of financial statements. However, in most accounting choice, studies attempts to explain the choice of a single accounting method (e.g the choice of depreciation) instead of the choice of the combination of accounting Policies and describes the existence of incentives and opportunity for top management team to use in improving FRQ. It is prudent to use the combination of accounting methods and Policies in order to test how the choice of the methods and Policies affect the quality of financial statements. The study majorly build on this theory and concept gap to contribute to theory building on how a combination of choices relate to FRQ.

Deegan and Unerman (2006 p.207) explain how accounting choices can be used to assist the functioning of the relationship. 'Managers make accounting choices through their decisions about what, how, and when to apply certain accounting principles'. This influences the perceived performance (the consequences of accounting choices on FRQ) of an organization. The theory seeks to explain and predict accounting practice more than just describing practice. This theory is also crucial in determining the effect of accounting choice variables on level of FRQ. The objective of the theory is to explain and predict accounting practices (Watts and Zimmerman 1986).

However, it does not provide CFOs with best practices to apply in preparation of financial statements. The functioning of the theory is based on three hypothesis; the bonus plan, the debt/equity and political cost hypothesis. These three hypotheses are used to explain and predict how firms make choices on particular accounting methods and earnings management, which is used many times as a proxy of FRQ. However, the theory is sillent on the role of audit committee, which play an oversight role in achieving high quality in financial reporting. It is prudent to discuss the three hypotheses briefly.

The Bonus Hypothesis

Healey (1985) attempts to explain and predict managers choice of accounting theory based on firms compensation plans. His hypothesis was that managers would find opportunities in which they would manage net income in an attempt to maximize their bonus if income tends to be between the bogey and the cap. Under these two conditions then managers would find an incentive to acquire accounting policies that increase net income, and thus increase a managers bonus. This kind of scenario is purely lacking in companies that do not base their compensations plan on income. Top management team in commercial state corporations are on fixed salaries by the public commision as for the case of Kenya. Watts and Zimmerman (1990 p.38) 'argue that managers of firms with bonus plans are more likely to use accounting methods that increases or maximises current period reported income

Contractual Motivation Hypothesis

Healey (1985) also hypothesizes on how debt contract can trigger the selection of discretionary accounting policies. Sweeney (1994) observed that a sample of firms defying covenants obligations actually took measures to implement income increasing accounting changes. Hence, managers tend to be motivated to change to new policies, as they felt an obligation to inflate reported net income. Watts and Zimmerman (1986) note that managers with high debt equity ratio are more likely to exercise discretion by choosing income increasing accounting methods'.

The debt covenant hypothesis states that the closer a firm is to compromising their debt covenants, the more likely management is to use accounting policies that shift reported earnings from future period to the current period. This is because higher net earnings will reduce the probability of technical default on the debts.

Political Motivations Hypothesis

To the extent that firms are politically visible, that is, they are often in the public eye or subject to governmental scrutiny, firms will use earnings measurement to reduce reported net income. This will circumvent external bodies from forcing a politically visible firm to lower its profitability. These findings are supported by empirical evidence from Jones (1991) and Cahan (1992). Political hypothesis assumption, given the cost of information and monitoring, managers have the incentive to exercise discretion over accounting profits. The argument here falls short of how to address firms with bonus plans and where the management do not have control and the source of financing as in most GOEs in Kenya.

Demographic Diversity of Top Management Team and Financial Reporting Quality

Identifying the personality characteristics of top management team is one of the important issues in corporate management. According to researchers, TMTs in each organization are significant and have an effective role in determining major goals and outcomes of their organizations. The motivation to examine the demographic diversity in TMTs has been on the premise of gains from a diverse working team. Hambrick et al, (2008) attributes quality reporting to top executives' personal characteristics but, Varman et.al (2010) argue that there is a significant difference between the effectiveness of TMTs and effectiveness of contextual factors. This is consistent with findings of Mackey (2008) who finds strong evidence in favour of the effectiveness of TMTs' characteristics on performance. The main focus of the review is to identify and confirm the relationship between demographic diversity and FRQ. Hillery and Hsu (2011) provides evidence that top executive directors influence the output of accounting information.

Collins et al (2009) argue that the results of many studies show that income is manipulated by top executives. This forms the basis why many researchers measure FRQ using earnings management quality, compliance with legal requirements, timely loss recognition, value relevance and qualitative characteristics (Bamber, 2010; Ling, 2012; Francois and Kyle, 2011; Outa, 2011; Barako, 2007; Steccolini, 2004). The second motivation into the study is that top management team is known to be putting more pressure on financial officers into manipulation of earnings for better image of the company (Hermalin et al. 2004). None of these studies has proposed an alternative measure (s) for FRQ, given that the studies are

conducted on companies listed in the stock exchange markets. Most of the literatures on financial reporting quality suffer from lack of a common benchmark for measuring accounting quality information.

The accounting literature on financial reporting quality shows that, quality reporting is basically measured using earnings quality and compliance with IFRSs (Outa 2011; Mutiso and Kamau 2013; Bamber 2010). However, Mahdavihou and Khatanlou (2011) have faulted the use of IFRSs compliance as the only measure of FRQ, while acknowledging earnings quality as a critical issue in financial reporting of every registered firm; most of the regulators only concentrate on the financial reporting quality of the listed firms. The use of earnings quality as a measure has raised a number of issues in terms of its reliability, since some TMTs use the measure opportunistically to meet their own utility.

Cohen et al. (2004); Graham et al., (2005) and Hambrick, (2007) suggest that management demographic diversity influence the quality of firm's statements. This variation in top managers' characteristics is perceived to have an impact on firm's financial reporting quality if linked with agency theory (Francois and Kyle, 2011; Ling, 2012). The management team is associated with BoDs, audit committees, internal auditors and external auditors' demographic characteristics. Other research on demographic diversity of TMTs have also provided support for gender, knowledge and professional differences in explaining the level of FRQ in firms (Bertand and Schoar, 2003; Boyatzis, 2004; Barua et al., 2010; Mahdavihou and Khatanlou 2011). However, most research work has concentrated on BoDs characteristics and governance mechanism. A few empirical studies done on demographic characteristics on top management are discussed below.

Gender Diversity

Gender is found to be effective on ethical works of TMT which stresses that men and women have unique interests and different tendencies in doing unethical behaviour in business (Betz 1998). Huang et al. (2011) argues that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such as manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income.

These two studies can be used as a pointer to the influence of women on FRQ. Goul et al, (2011) argue that women should form part of the TMT because of their moral judgment and maintenance of expected shareholders value. Beramer et al, (2009) believes that presence of women in TMT increases sense on interaction in the firm before decisions are taken; the opposite is for a male dominated TMT that leads to financial crisis. Guol et al, (2011) indicate that the presence of women in TMT increases qualitative level of reported incomes. Gervais and Odean (2001) document that gender diversity in TMT dealing in accounting matters improves FRQ. Most of the FRQ is much concentrated on earnings quality rather than other quality measures.

Barua et al. (2010) finds a significant relationship with female CFOs and financial reporting quality. Their argument is that female CFOs are likely to be less aggressive in making judgment related to discretionary accruals. Thus, firms with female CFOs would be more likely to have higher accrual quality. The findings show that companies with female CFOs have lower performance matched absolute discretionary accruals and estimation error. This is an indication of high-financial reporting quality. However, the study only used one

variable, gender on FRQ (measured using accrual estimate error and performance matched abnormal accruals). This gap is bridged in the current study by introducing four other independent variables namely, age, tenure, education and functional background of the TMTs in commercial state corporations. On the measurement of FRQ the study also introduces other measurement namely, fundamental qualitative characteristics, disclosure quality and timeliness reporting of accounting information.

A team of female CFOs produce high quality financial information. But most of these studies have not looked at gender diversity in a team or a group of top management, which is the main focus of the present study. Marimuthu and Indraa (2009) examine the demographic diversity of BoDs and TMTs on firm financial performance in the non-financial listed companies in Malaysia and found no relationship with TMTs' diversity but a significant relationship with BoDs characteristics. However, financial performance is a function of top management. The study uses two TMT diversity variables (ethnicity and gender) measured using a ratio scale and financial performance was measured using return on equity (ROE). The limitation to the study could be attributed to the number of TMTs' variables used (gender and ethnicity) and the scope of the study. This gap is bridged in the current study by introducing other four variables and focusing on commercial state corporations in Kenya rather than listed companies. If other TMTs' variables are included, the findings could be different.

Tenure Diversity

Tenure is one of the most important personal characteristics which give rise to distinct patterns of decision makers' cognitive process, attention and financial decisions (Wiersema and Bental 1992). Hambrick and Fukutomi (1991) argue that long tenured executives generally increase the commitment to a paradigm, decrease open mindedness, information diversity and task interest, while they increase their knowledge and task. Ali and Zhang (2012) show that CEOs have greater incentives to overstate earnings in early years than later years of their service. Bedard et al. (2004) and Liu and Sun (2010) find negative relationship between top managers and their tenure in service. They argue that directors with long tenure have much experience and task knowledge resulting in effective monitoring, hence improved FRQ.

There is a contradiction to these findings; Kim et al. (2013) find that the absolute value of discretionary accruals decreases when tenure of top management team increases. They measured FRQ using three proxies namely; discretionary accruals, earnings persistence and earnings response coefficient (ERC) for companies listed. The study improved and filled the gaps ignored by other studies such as Deschow et al. (2010) who do not consider the demographic characteristics of TMTs or decision makers as a factor affecting FRQ. The current study further improves the gap by introducing other measures of FRQ namely, fundamental qualitative characteristics, disclosure quality and timeliness in reporting accounting information.

Functional Background

Francois and Kyle (2011); Hua-Wei et al (2012) examine the role of top executive's (CEOs, CFOs) functional background on financial reporting choice and found a significant explanatory factor. Their argument was that top executive's functional background is a significant determinant of accounting

decisions and financial reporting quality. This argument is supported by Upper echelons theory which suggests that manager's age cohort, tenure and education can affect TMTs' values, cognitive styles, and thus decisions (Hambrick and Mason 1984).

The studies used longitudinal design focusing on listed firms. Krishan et al. (2011) find that the presence of directors with legal background on audit committee is associated with high quality financial reporting. The FRQ is measured using earnings quality and financial restatements. This leaves room for other TMTs demographic variables to be examined against disclosure quality, qualitative characteristics and timelines (FRQ) to confirm the same.

Mahdavi-khou and Khatanlou (2011) in their study point out that professionalism in accounting promotes the quality of financial reporting. Their study focused on the impact of professional ethics of financial managers in the listed firms on Tehran stock exchange and found a significant relationship between professional ethics and FRQ. However, the study did not explore on professional diversity. The study measured the level of FRQ using qualitative characteristics of financial reporting based on IFAC and IASB.

Age Diversity

The principle underlying assumption in diversity studies is that, there is a direct relationship between individual characteristics of CEO and risk facing FRQ. The theory of upper echelon (Hambrick and Manson 1984) document that the characteristics of top executives influence their discretion and the outcomes of their firms. By nature, younger persons are different from the older, physically and ethically. Gibbons and Murphy (1992) document that person's behaviour and incentives are conditioned by age. Hambrick and Manson (1984); Joos et al. 2003) and Davidson et al.(2007) note that younger managers are likely to engage in earnings management, while older managers mostly concentrate on future security, hence, have less ability to generate new ideas and more concerned about future security. This argument is interpreted to mean that quality of financial information is a function of TMT age.

Sundaram and Yermack (2007) find a positive relationship between age and ethical behaviour on financial reporting quality. Mudrack (1989) in his study about determinant component of ethical behaviour finds older persons are more exposed to traditional customs and culture, hence more ethical. Financial reporting quality is all about ethics of the accounting profession. Talbi (2014) conducts an empirical study on a sample of US listed firms (S&P1500) from 2000 to 2009 on the relationship between CEO age and financial reporting quality. The study measures FRQ using earnings management based on operating activities manipulations, abnormal cash flows and abnormal discretionary expenses.

The CEO's age was regressed against earnings management and the results were robust. The study finds positive relationship between CEO age and real earnings management. The nature of the relationship was not monotonic but had a U-shaped with inflexion point equal 48 years. This was interpreted to mean that, real earnings increase when TMTs is composed of young managers. Thus, our assumption is that real earnings management increases when the manager is young and decreases when manager is old. This is consistent with Graham et al. (2005) confirms that CFOs are willing to engage in earnings manipulation in order to meet the threshold. The 80% of his respondents were willing to reduce their discretionary spending in R&D, advertising and

maintenance expenses. Therefore, with the use of different proxies for FRQ, and demographic diversity variables on each study reviewed, it becomes difficult to compare FRQ across different firms, hence the proposition that: Demographic diversity of top management team has no significant influence on financial reporting quality in commercial state corporations.

Financial Reporting in Kenyan Commercial State Corporations

Accounting and Financial reporting requirements of Kenyan commercial state corporations are regulated by a multiplicity of laws and regulatory bodies. These include the companies Act cap 486, Nairobi Securities Exchange Act, central Bank of Kenya Act, the capital markets authority Act and state corporations Act. The Kenyan Companies Act sets the general framework for financial accounting and reporting by all registered companies in Kenya, and stipulates the basic minimum requirements with regard to financial reporting. The regulatory framework governing reporting in Kenya comprise statutory framework governing the accountancy profession and financial reporting in Kenya. This precisely includes the companies Act (CAP 486), industry specific legislations governing financial reporting (CDG 2006).

Financial reporting practices are perceived to have improved significantly in Kenya since ICPAK's decision to implement international standards in accounting and auditing. Therefore corporate financial reporting becomes an important avenue for communicating company's financial and non-financial information. Commercial state corporations have not been doing well in terms of financial reporting. Kariuki and Jagango (2013) argue that quality financial information should be reflected in the security prices, but this should only be applicable to the listed companies. Wagacha (2001) notes that predominant reason for listing is to access cheaper funds from the financial markets. Zairi and Letza (1994) make different assertion on why companies should practice financial quality reporting. The intention of financial reporting quality is to show what is actually happening to an entity, expressing the silent facts as far as practicable in financial terms. The major focus of the study is to examine the FRQ in the commercial state corporations which are generally not listed. But it is reported that by 1996, the Kenyan had started selling state owned enterprises (African Financial Review, 1996). The major question is how was the financial reporting quality of these state owned enterprises determined?

Outa (2011) found out that the level of FRQ in listed companies was generally low using both quality disclosure and compliance with IFRSs, but showed an improvement over the study period. The studies used longitudinal research design. Mutiso and Kamau (2013) examined how disclosure, adaptation of IFRSs, regulations and lack of competence by preparers contribute to the complexity of preparing financial statements. The study adopted descriptive study design focusing on the registered banks. The major findings revealed a number of variables contributing to complexity in preparation of statements of firms. Management interference was a major contribution to complexity in financial reporting. However, the study failed to explore on which management characteristics contributes to the interference with quality of financial reporting.

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. A survey conducted in Kenya by (ROSC 2010) attributes the low FRQ to reluctance of top management to

comply with the full disclosure and transparency requirements of IFRSs. However, the report noted that non-listed entities, including commercial state corporations have significant public interests, but no study has been done. It is on this account that the current study intends to address other proxies of FRQ and determinants such as demographic diversity of top executives and discretionary accounting.

However, Miringu and Muoria (2010) conducted a study in CSCs examining how corporate governance affects performance in CSCs. The study used descriptive survey with a study population of 41 CSCs. The findings revealed a positive relationship between ROE and board size and board composition of all CSCs. The current study builds on the following hypotheses:

- H01:** Demographic diversity of top management team has no significant effect on financial reporting quality in the commercial state corporations in Kenya.
Given that the study measures financial reporting quality using four distinct variables, the following four sub hypothesis were derived from the hypothesis one.
- H01a:** Demographic diversity of top management team has no significant effect on disclosure quality in commercial state corporations in Kenya.
- H01b:** Demographic diversity of top management team has no significant effect on fundamental qualitative characteristics in the commercial state corporations in Kenya.
- H01c:** Demographic diversity of top management team has no significant effect on earnings quality in commercial state corporations in Kenya.
- H01d:** Demographic diversity of top management team has no significant effect on timeliness quality in commercial state corporations in Kenya.

RESEARCH DESIGN, SAMPLE DATA AND VARIABLES

The study adopted both correlational research design and longitudinal research design. Correlational research design suits this kind of study since it attempts to establish the existence of relationships among variables. It is used to describe the statistical association between two or more variables and ensures that all cross sectional variations are included in the model. The design helps in determining the extent to which the variables of the study are related. However, it does not 'prove' a relationship; it only indicates an association between the variables (Creswell, 2008 and Ludica et al, 2006). The weakness of correlational design can be strengthened by the use of longitudinal study design.

The longitudinal research design has strong controls for the firm specific effects to avoid misattributing firm effects to TMT (Bertrand and Schoar 2003). The longitudinal research design helps to detect the changes in the characteristics of target population at both group and the individual level. The design is quite useful in describing patterns of changes in the study variables, hence makes it possible in establishing the direction and magnitude of causal relationships. It allows researcher to differentiate between change over time in aggregate data and in individual (Rutter, 1988).

There were a total of fifty five (55) commercial state corporations in Kenya as presented by Inspectorate of state corporation 2014. The population was purely drawn from commercial state corporations in Kenya, which were categorized as; commercial state corporations or commercial state corporations with strategic functions. All the 55

commercial state corporations were included in the study, hence a census study.

After filtering the populations a total of 30 commercial state corporations with complete data were selected. This yielded firm year observations of 248 individual TMTs and 241 annual financial statements. The study used pooled data mainly drawn from secondary sources. The data was extracted from audited financial statements and management reports (MD&A) specifically chairman's report, Managing director's report and auditor's general reports obtained from the individual state commercial corporations and the relevant parent ministries using secondary data capture form for the period 2004 to 2013.

Multicollinearity of the regression models was tested to ensure that the coefficients of independent variables are statistically significant. The variance inflation factor (VIF) for all the variables fitted in the regression models were smaller than 2 for each case of the variables tested. This was an indication that there is no Multicollinearity among the study variables. However, Gujarati (2003) suggests that Multicollinearity exists when the correlation exceeds 0.80 and when VIF value for each independent variable is greater than 10. The study concluded that there was no Multicollinearity problem within the study variables. Given the objective of this study and the hypotheses to be tested, the model was formulated and presented below;

$$FRQ = \beta_0 + \beta_1 Gen + \beta_2 Edu + \beta_3 Age + \beta_4 Ten + \beta_5 FBG + \varepsilon \quad (3.1)$$

ANALYSIS OF FINANCIAL REPORTING QUALITY

A number of studies have used different measures for quality reporting. However, to measure the financial reporting quality comprehensively in the CSCs, four proxies were used to measure FRQ since there is no universally accepted measure(s) of FRQ (Deschow, Ge and Schrand, 2010). Secondly the use of a single proxy was unlikely to cover all facets of FRQ and to generalize results and test for robustness of the research results. This study used four models to assess the quality of financial and non-financial reporting information in the annual reports considering all dimensions. The study models used were: disclosure quality index, timeliness quality index, fundamental qualitative characteristics model and the earnings quality model.

Disclosure Quality Model

Chen et al., (2013) define disclosure quality (DQ) as account of numbers of non-missing items in firms' financial reports. It uses value weighted scheme to give more weight to items that presumably are more important to firm operations and thus to other stakeholders. The determination of this measure is based on the requirements of the statutes in the form of laws, professional regulations, international accounting standards and listing rules in stock exchanges (Graham, Harvey and Ragopal 2005). This measure allows for the determination of inclusive disclosure within the financial statements and help in assessing the level of compliance with mandatory disclosures. The model determines the extent of quality through disclosure quality index (Lang and Lundholm 2003). The measure is generally based on disclosures made within the annual financial statements.

In order to measure FRQ, the study used disclosure quality index to test for the extent and the frequency of the overall quality disclosures based on all balance sheet and

income statement line items either reported in the financial statements or in the footnotes using disclosure quality model. Disclosure quality (DQ) model is an overall measure of fineness of financial statement information. It captures the level of details of accounting data items included in the annual reports. DQ Balance sheet (DQBS) index and DQ income statement (DQIS) index varies between 0 and 1 and is determined as:

$$DQISIDQBS = \sum_{k=1}^n \left(\frac{\# \text{ non-missing items}}{\text{Total \# Items}} \right)_k \times \frac{Sh. I_k}{Sh. TI} \div 2 \quad (3.2)$$

DQ IS uses an equal weighting to arrive at the Income Statement disclosure scores. A ratio of non-missing items in each group is determined, and then used to compute an equal-weighted DQ score for the income statement by averaging the ratio of non-missing items over the groups. DQ_{it} index is then computed by simple average of DQ BS and DQ IS indices which is then used as a measure of disclosure quality. The index used ranges from 'zero' to 'one', where 'index of one' is high quality disclosure and 'zero' is no disclosure.

The study identified major accounts (noncurrent assets, current assets, current liabilities, non-current liabilities and equity) from statement of financial positions across all the firms presumed to be important for the stakeholders. The missing items were drawn through screening mechanism of CSCs annual financial statement using leading Commercial state corporations (listed at NSE) due to lack of sufficient data for the targeted populations. Chen et al., (2013) suggest that well developed markets provide sufficient missing items with ease. This is arrived at after grouping the corporation into a cluster of sameness.

Timeliness of Financial Statements

Timeliness means having information available to decision makers before it loses its capacity to influence decisions' (IASB, 2008: 40). Timeliness is also used to measure financial reporting quality of firms. It is measured using the natural logarithm of amount of days between year-end and the signature on the auditors' report after year end.

Timeliness of financial reporting is operationalized as the number of days between fiscal year end of each commercial state corporation and the date of the audit report for each year examined. However, each commercial state corporation has its own reporting date but should be within the period not more than 3- 6 months after the end of a financial year. Ahmed (2003) timeliness of financial reports is useful for decision making before that information loose capacity to influence those decisions.

Fundamental Qualitative Characteristics

The qualitative characteristics have been used in many studies to proxy FRQ. The characteristics are divided into fundamental and enhancing characteristics. This study adopted faithful representation, relevance and understandability characteristics as measures of quality reporting. Relevance, faithfulness representation and understandability variables were analyzed using a five point rating scale to assess the scores on the items presented and disclosed in the financial statements of commercial state corporations and as used in IASB (2008) and Mahdavihou & Khatanlou (2011). The characteristics were based on fourteen questions cutting across on both financial

and nonfinancial accounting information. The points awarded to each question are used to compute standardized scores on each qualitative characteristic. The standardized scores are added together then averaged, to ensure that both the characteristics are weighted equally. The scores range from 1 to 5; where 1 indicate poor quality and 5 implies excellence.

Jonas and Blanchet (2000) and Lee et al, (2002) developed questions referring to separate qualitative characteristics in order to assess information quality. The qualitative characteristics are divided into two major aspects, namely, the fundamental qualitative characteristics which are used to determine the content of financial reporting information and the enhancing qualitative characteristics used to enhance the fundamental characteristics. Beest et al. (2009) who used a 21- item index in determining FRQ in the listed companies in the US and UK confirms the reliability of the measures. The current study has modified the 21-item index by Beest et al. (2009) to 15- item index focusing only on three aspects of qualitative characteristics.

Discretionary Accruals

Dechow and Dichev (2002) suggest that a high quality accrual is eventually realized as cash flows. However, accruals that are made due to errors in estimations or earnings management will not be realized as cash flows. The Jones model of discretionary accrual (1991) has been identified as one of the best estimates of earnings management. The earnings quality is used to proxy FRQ of the commercial state corporations. The earnings are said to be of higher quality when they exhibit persistence, unbiased and sustainable to forecast future cash flows. Earnings management is measured using discretionary accruals, either balance sheet or cash flow statement approach. The two approaches are meant to detect unusual figures associated with the reported amounts from the two financial statements.

The accrual based accounting is specified into, discretionary accruals and non-discretionary accruals. Bauwhede (2003, p.198) describes ‘discretionary accruals as that portion of the firm’s accrual that cannot be explained by the company’s normal operating activities. Non-discretionary accruals are accruals that lie in the line of expectations when looking at normal operating activities.’ The difference between the two types of accrual depends on the influence the manager has to adjust the particular accrual. Discretionary accruals include managers’ impact on accounting choices. The discretionary accrual (DACC) has to be determined from total accruals (TACC) of the firm at a particular period since it represent the greater degree of subjectivity and are open to manipulations. The firm’s total accruals are defined as the change in non-cash current assets minus the change in current liabilities excluding the current portion of debts, minus depreciation and amortization, scaled by lagged total assets.

$$TACC_{i,t} = \Delta CA_{it} - \Delta CL_{it} - \Delta CASH_{it} + \Delta STD_{it} - DEP_{it} \tag{3.3a}$$

Where: $TACC_{it}$ – is firm i’s total accruals in year t, Δ is change in year firm i’s, in year_t, CA is current asset, CL – is current liabilities, STD – is debt included in current liabilities from t-1 to year t. and CASH –is cash equivalent form t-1 to year t. The total earnings quality is calculated using Collins and Hribar (2002) model as follows:

$$TACC_{i,t} / TA_{it-1} = \beta_1 (1/TA_{it-1}) + \beta_2 (\Delta Sales_{i,t} - \Delta RECI_{i,t} / TA_{it-1}) + \beta_3 (PPE_{i,t} / TA_{it-1}) + \epsilon_{i,t} \tag{3.3b}$$

Where:

TACC = Total accruals of a given firm in year t (total accruals equal income before extraordinary items less operating cash flows); **TA** = Total assets; $\Delta Sales_{i,t}$ is change in firm i’s Sales from year t-1 to year t, $\Delta RECI_{i,t}$ is change in accounts receivable from year t-1 to year t, **PPE_{i,t}** is firm i’s gross property, plant & equipment at year t.

The estimates of β_1 , β_2 and β_3 obtained from these regressions are then used to estimate discretionary accruals using modified Jones model (1991) as follows:

$$DACC_{it} = TACC_{it} / TA_{it-1} - [\beta_1 (1/TA_{it-1}) + \beta_2 (\Delta Sales_{i,t} - \Delta RECI_{i,t} / TA_{it-1}) + \beta_3 PPE_{i,t-1} / TA_{it-1}] + \epsilon_{i,t} \tag{3.3c}$$

Where: **DACC** = Discretionary accruals

Interpretation of discretionary accrual as a measure of quality is important. High amount of discretionary accruals indicate lower quality earnings and should be a red flag that management may be using an aggressive accounting to overstate earnings. However, high accruals may not always mean manipulation of earnings. Earning management may either increase the corporation’s current earnings or defer the current earnings to the future accounting period.

Analysis of Demographic Diversity of Top Management Team

The study employed standard deviation, coefficient of variation and blau index to measure the maximum diversity of particular demographic attributes and heterogeneity. The minimum value of the blau and coefficient of variation indices equals (0) for all the diversity and maximum value equals (1). Other, Studies dealing with demographic characteristics such as gender, age, and ethnicity that have adopted the analysis techniques such as (Krishnan and Park 2005; Harrison and Klein 2007) where the findings have been robust. Since gender, education and functional background are categorical variables; blau index was constructed to measure the variables.

Frequencies were used to summarize the variables before determining blau heterogeneity index of TMTs across CSCs. TMTs’ education heterogeneity was classified into six categories and TMT functional background heterogeneity into twelve categories using information from the pooled data. Blau index was then used to test for heterogeneity across the teams’ gender, education background and functional background of the team of top management.

$$BI = 1 - \sum p_{ij}^2 \tag{3.4}$$

Where: BI is the blau index for state commercial corporations; P_i will be proportion of individuals in each category of diversity; j is the number of different categories or features across all the groups. Since age and tenure are continuous variables will be measured using number of years, however, top level management heterogeneity along this dimensions will be measured as coefficient of variation defined as:

$$CV = \delta / u \tag{3.5}$$

Where: CV is coefficient of variation, δ is standard deviation of TMTs and u is the mean of TMT’s age and tenure.

The focus of this study was to make comparison of demographic diversity of TMTs across commercial corporations. In order to make the comparison, the indices were normalized to allow comparisons among the groups by reducing the inflating effects on group size. Within the group size. The maximum value of a group diversity measurement is a function of the group size and distribution of members. All normalized indices range from (0 to 1).

RESULTS AND FINDINGS

In testing the first sub-hypothesis, the five demographic diversity variables were entered into the model against the response variable disclosure quality using stepwise regression. The results of the regression coefficients show that, tenure diversity, education diversity and functional diversity are positively related to disclosure quality but insignificant in explaining the effect. Age and gender diversity are inversely associated with disclosure quality and are insignificant in explaining the effect on disclosure quality.

The multiple regression stepwise analysis generated five regression models as presented in Table 5.1a, 5.1b, 5.1c and 5.1d below. From the stepwise regression results in Table 5.1a above, five models have been generated using stepwise approach. The stepwise multiple regression model number five is the most insignificant model since it has the inclusion of all the demographic diversity; the results are insignificant at the set confidence level of 95%.

Also from the model it can be observed that as one moves from the stepwise model number one to five, the F values keeps decreasing and increasing thus not stable. The Adjusted R-squared also keeps improving from (-0.004) to (0.002). Model five indicates that the effect on disclosure quality is insignificant at $p = 0.360$. Model five shows a weak relationship between demographic diversity of TMT and disclosure quality, implying that the demographic diversity of TMTs only explain 2.0% of change in the CSCs disclosure quality. The model is not a good predictor of FRQ.

Further analysis from correlations indicate that there is no significant relationship between demographic diversity and disclosure quality. The model therefore is unfit to explain the effect of demographic diversity on FRQ using the disclosure quality. Since the test for significant ($P < 0.001$) is not attained with all independent variables, the proposition that demographic diversity of TMT has no significant effect on (financial reporting quality) disclosure quality is therefore confirmed.

H01b: *Demographic diversity of top management team has no significant effect on fundamental qualitative characteristics in commercial state corporations in Kenya.*

In testing sub-hypothesis (H0_{1b}), stepwise regression was used and the regression model results show significant effect of all the demographic diversity variables (age diversity, tenure diversity, gender diversity, education diversity and functional diversity) on FRQ proxied by fundamental qualitative characteristics. The fundamental qualitative characteristics were measured using three items (relevance, faithful representation and understandability). The three items were measured using standardized scores. The minimum score was one (1) and the maximum score was five (5). The three items were then combined together to get a standardized scores used in the regression model. The information on the measures were collected through secondary data capture form

in Appendix I, II and IV. Table 5.1b(i) below presents the results of the five demographic diversity variables and fundamental qualitative characteristics.

From the regression results in Table 5.1b(i) above, five models have been generated using stepwise approach. The stepwise multiple regression model number five is the most significant model since it has the inclusion of all the five demographic diversity variables of TMTs; the results are significant at the set confidence level of 95%.

Also from the model it can be observed that as one moves from the stepwise model number one to five, the standard error of the estimate keeps decreasing from (0.66160372418) to (0.62659314162) as so does the F values. The adjusted R-squared also keeps improving from (0.029) to (0.129). This implies that 12.9 % of change in fundamental qualitative characteristics of accounting information is explained by the five demographic diversity variables of TMTs in commercial state corporations in Kenya.

In order to determine which variable is the most parsimonious in explaining the change in financial reporting quality as proxied by fundamental qualitative characteristics. Table 5.1b (ii) shows the contribution of each demographic diversity variable of TMTs in commercial state corporations.

The findings of the relationship is confirmed by the results of regression coefficients (0.173, 0.146, -0.138, -0.162, and 0.241). The regression coefficients reveal the level of contribution at level of significant of 5% with all the variables. The most demographic diversity variables contributing positively to the change in financial reporting quality are; functional background, age and tenure. (B= 0.241, 0.173 and 0.146). The three variables are positively related to FRQ using fundamental qualitative characteristics.

Further findings reveal that gender and education are significant at $p < 0.05$ but negatively associated with FRQ. They contribute to the study inversely, where a unit change in education diversity and gender diversity results into enhancement of financial reporting quality in commercial state corporations by (16.2% and 13.8%). the interpretation is that demographic diversity has significant effect on financial reporting quality. The five variables/ indicators used in measuring demographic diversity of TMT exhibit both negative and positive coefficients. Model five being the most significant model indicates that the effect on fundamental qualitative characteristics is significant at $p = 0.000$ and has weak positive relationship between demographic diversity of TMT and fundamental qualitative characteristics. Hence sub hypothesis H01b is rejected.

H01c: *Demographic diversity of top management team has no significant effect on earnings quality in commercial state corporations in Kenya.*

In testing the sub-hypothesis (H0_{1c}), multi-linear regression analysis was used. The linear regression results indicate significant effect with functional background diversity and age diversity in TMT. The results of the regression is shown in Table 5.1c. The adjusted coefficient of determination is (0.070) and F-statistics of 4.389, hence the relationship between demographic diversity and earnings quality is positive. This implies that only 7% of the variance in earnings quality is explained by the two variables. The remaining 93% is explained by other factors not in this model. The factors not included may be firm characteristics and other noise factors in accounting decisions.

Table 5.1a (i): Regression results of demographic diversity effect on disclosure quality

Model Summary				
Models	Adjusted R²	F	Significant level	
Model 1	-0.004	0.073	0.787	
Model 2	-0.008	0.121	0.886	
Model 3	-0.005	0.656	0.58	
Model 4	-0.007	0.587	0.672	
Model 5	<u>0.002</u>	<u>1.103</u>	<u>0.36</u>	

1. Predictors: (Constant), Age
2. Predictors: (Constant), Age, Tenure
3. Predictors: (Constant), Age, Tenure, Gender
4. Predictors: (Constant), Age, Tenure, Gender, Education
5. Predictors: (Constant), Age, Tenure, Gender, Education, Functional Background

Table 5.1a (ii): Pearson correlation between demographic diversity and disclosure quality

Variable	Disclosure Quality	Significant
Disclosure Quality	1	0.00
Age Diversity	0.013	0.841
Tenure Diversity	0.028	0.666
Gender Diversity	-0.087	0.186
Education Diversity	0.04	0.547
FBG Diversity	0.126	0.054*

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

Table 5.1b(i): Regression results of demographic effect on fundamental qualitative characteristics

Models	Adjusted R²	Standard Error of Estimate	F	Significant level
Model 1	0.029	0.661603724	7.977	0.005
model 2	0.056	0.652118671	8.048	0.000
Model 3	0.071	0.647167513	6.979	0.000
Model 4	0.077	0.644839471	5.944	0.000
Model 5	0.129	0.626593142	7.978	0.000

1. Predictors: (Constant), Age
2. Predictors: (Constant), Age, Tenure
3. Predictors: (Constant), Age, Tenure, Gender
4. Predictors: (Constant), Age, Tenure, Gender, Education
5. Predictors: (Constant), Age, Tenure, Gender, Education, Functional background
6. Dependent Variable: Qualitative Characteristics

Table 5.1b (ii): Beta coefficients results of demographic diversity effect on qualitative characteristics

Variables	Standardized coefficient	t-value	Significant	VIF
Constant	2.02	7.398	0.000	
age	0.173	2.76	0.005	1.061
Tenure	0.146	2.386	0.018	1.016
Gender	-0.138	-2.235	0.026	1.03
Education	-0.162	-2.548	0.011	1.101
Functional Background	0.241	3.835	0.000	1.072

Table 5.1c: Beta coefficients results of demographic diversity effect on earnings management

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	F	Sign
1	.302a	0.091	0.07	0.7657609	4.389	0.001

Variables	standardized coefficient	t-value	Significant
Constant	1.835	5.299	0.00
age	-0.118	-1.769	0.045
Tenure	-0.098	-1.519	0.13
Gender	0.063	0.951	0.343
Education	0.022	0.327	0.744
Functional Background	-0.235	-3.529	0.001

a. Predictors: (Constant), Functional Background, Gender, Tenure, Age, Education

b. Dependent Variable: Earning Management

Table 5.1d (i): Regression model summary for demographic diversity and timeliness

Model Summary	R	R-Square	Adjusted R ²	Std. Error of Estimate	F	Significant
	0.271	0.073	0.053	4.9677845235	3.668	0.003

Variables	Standardized coefficient	t-value	Significant
Constant	13.537	6.82	0.000
age	0.12	1.842	0.46
Tenure	-0.239	-3.741	0.000
Gender	0.023	0.36	0.719
Education	-0.024	-0.356	0.722
Functional Background	0.082	1.219	0.224

Further results of the regression analysis show that three demographic diversity variables (gender, education and tenure) have insignificant effect on earnings management quality. The results only show significant effect between TMTs' functional background and age on earnings quality. The functional diversity and age are inversely related to earnings quality (b=-0.235, -0.118 t=-3.529, -1.769). This is interpreted to mean that earnings quality improves inversely with changes in functional diversity and age diversity. Good financial reporting improves with the reduction of diversity in age and functional background of the TMTs in commercial state corporations. The effect is described as negative relationship. Table 4.1c represent the outcome of the model.

The interpretation is that a unit change in functional background of TMT, would result in a reduction of financial reporting quality by -0.235(23.5%). This implication is that appointment in top management a long functional background and age is critical and has impact on FRQ in state commercial state corporations. The two variables give the size of the effect of independent variables on the predicted variable. Since two out of five variable within the model are statistically significant with earnings quality management. Then variations in functional background and age of TMT is said to influences

the level of financial quality. The sub-hypothesis H01d is not confirmed, thus the nul hypothesis is rejected.

H01d: Demographic diversity of top management team has no significant effect on timeliness quality in commercial state corporations in Kenya in Kenya.

In testing the sub-hypothesis (H0_{1d}), the results of regression showed significant effect with timeliness quality variables. Table 5.1d (i) and (ii) present the effect of demographic diversity of TMTs on timeliness reporting. The result from model summary shows that adjusted R-square is 0.053 implying that 5.3% of the variation in FRQ in commercial state corporations is explained by age and tenure of TMT. The relationship between demographic diversity and timeliness in reporting is positive.

The beta values for tenure diversity and age were significant at p= 0.05 level of significant. F- statistics is 3.668 and p =0.003. The beta coefficients in Table 5.1d (ii) indicate that out of five demographic variables of TMT namely; age, gender, tenure, education and functional background, only age diversity and tenure diversity have significant effect on FRQ. Tenure diversity is inversely associated with FRQ (B= -0.236, t= -3.741). This implies that a unit change in tenure diversity

would result to reduction in FRQ by 0.239 (23.9%). Using timeliness reporting quality would mean that FRQ would improve as number of days to release financial statement improves and reduces. Age diversity has a positive coefficient ($B = 0.120$, $t = 1.842$), which implies that a change in age diversity by a unit (index) will result into an increase in FRQ by 0.120 (12%). This means that the increase in number of days results to reduction in FRQ. This is finally interpreted to mean that it takes CSCs longer days to provide information to the general public and other interested stakeholders. Age diversity becomes a factor in determining timeliness in reporting in CSCs in Kenya. Since the two variables reveal significant effect on timeliness and adjusted R^2 account for 5.3% variability in timeliness in reporting at 5% level of significant, thus the sub-hypothesis two (d) is rejected.

The test for the hypothesis one shows that demographic diversity variables (functional background, education diversity, gender diversity, age and tenure diversity) are statistically significant with fundamental qualitative characteristics, earnings quality management and timeliness quality. The results only had insignificant effect on disclosure quality. The overall findings show that, out of the four dependent indicators namely; disclosure quality, qualitative characteristics, earnings quality and timeliness reporting, at-least three indicators (fundamental qualitative characteristics, earnings quality and timeliness quality) are statistically significant with group of demographic diversity variables namely age, gender, education, tenure and functional background as shown in the regression results in Table 5.1a- 5.1d above. The hypothesis one is therefore rejected.

DISCUSSIONS AND CONCLUSION

The objective of the study was to determine the effect of demographic diversity in top management team on financial reporting quality in commercial state corporations in Kenya. It was hypothesized that demographic diversity in top management has no significant effect on financial reporting quality in commercial state corporations in Kenya. The study derived four sub hypotheses from the main hypothesis and the findings summarized in Tables above in sections five.

The results from these analysis and interpretation indicate the presence of significant effect of gender, age education, tenure and functional background diversity in TMT on fundamental qualitative characteristics, earnings quality and timeliness reporting of accounting information. However, the relationship or the effect is not so much on earnings quality variable and timeliness reporting variable, since not all the five independent variables moved in the same direction with the FRQ indicators. Demographic diversity variables (age and functional background) were statistically significant in explaining earnings quality in commercial state corporations in Kenya and the variance in timeliness reporting quality in commercial state corporations in Kenya could only be explained by two demographic diversity variables (gender and tenure).

Theoretical and previous research evidence provides some support to these findings. From theoretical point of view the role of individual factors and team processes have significant effect on firms outcomes. This is in line with the upper echelon theory as suggested by Hambrick and Manson(1984) whose focus is on characteristics of TMT rather than individual managers in order to have better outcomes for the organization. In the modern companies today, the philosophy of team work is the gateway to success and quality outcomes of any corporation. The theory becomes critical in

understandings how TMT characteristics influence the outcomes of organisations namely; performance, quality of financial reporting, corporate voluntary disclosure and accounting choices. Although the major assumption of the UET is that human limitations influence the perception, evaluation and decision about organization problems, the theory still provides a general guideline on management influence on choices, behaviour and the process used in constituting the top management board and working committees.

The partial effect experienced by demographic variables on financial quality as measured under different measurement are also in line with the upper echelons theory. Table 5.1c presents results on demographic diversity effect on earnings quality. Out of five independent variables, only two variables were statistically significant. This partial effect is interpreted from the low adjusted R^2 . The theory clearly states that organization's outcomes, strategic choices either in management, finance or accounting and performance levels are partially predicted by Managerial background characteristics (Hambrick and Manson 1984). Other factors not in the model can be explained by the remaining percentages.

The findings from Table 5.1a and 5.1b indicated that age, gender, tenure, education and functional background are not statistically significant on disclosure quality in annual statements of commercial state corporations in Kenya. This leads to the confirmation of the null hypothesis. The study findings are consistent with Chen et al. (2013) who find that well developed markets provide sufficient missing items with ease that may not call for the intervention of the TMTs' influencing the process in determining quality report reporting. The study reveals that quality disclosure measure is more of mandatory requirement than a voluntary tenet, hence, very little effect was reported with variation expected from top management team in CSCs.

The second sub- hypothesis (H01b) was rejected since the findings indicate that; age, gender, tenure, education and functional background of TMTs have statistically significant effect on FRQ (fundamental qualitative characteristics). The third sub hypothesis one confirms that only age and functional background of TMTs have a significant effect on FRQ (earnings quality) in commercial state corporations in Kenya. These findings are consistent with Aier et al. (2005) who find that CFOs with financial experts are less likely to manage earnings. The same findings are confirmed by Bamber et al. (2010), provide evidence on association between earnings management and functional background of the top management. Although some of the empirical studies are based on CEOs, CFOs and Audit committee, the concept of the current study is built on these studies. The direction and the effect may be different, but the implication is the same.

The fourth sub hypothesis reveals that tenure and age of the TMT have significant effect on FRQ (timeliness in reporting) in commercial state corporations in Kenya. All these findings are consistent with empirical studies in section 2.3. For example, Bertrad and Schoar(2003) document that managers fixed effects explain a significant portion of the cross-sectional variation in corporate outcomes. The outcomes may be varied depending on the objective of each study. For the current study the outcomes are described as financial reporting quality in commercial state corporations. The demographic diversity variables of TMTs have explained aportion of variation in FRQ under different proxies namely disclosure quality, earnings quality and timeliness reporting. The effect of demographic diversity of TMT on financial reporting quality which is measured on earnings quality, fundamental qualitative

characteristics, disclosure quality and timeliness in reporting were summarized using coefficient of determination, Beta values and t statistics.

Bamber et al. (2010) used demographic diversity in explaining the outcome of financial disclosure in the listed companies. In their study, they found a significant influence of top executives characteristics on corporate voluntary disclosure. However, their study only explained the portion of how corporate voluntary disclosure is influenced by top executives characteristics. Ge et al. (2011) Investigated the effect of CFOs individual characteristics on financial reporting practices in the listed firms. Their findings show that a significant portion of the variation in financial reporting practices are explained by CFOs' characteristics. Their study only looked at one section of the TMTs.

The overarching conclusion is that demographic diversity of top management team has distinct characteristics which affect their corporations outputs. Although it is difficult from the findings of the study to conclusively attribute all the five demographic diversity variables to financial reporting quality per se given that financial reporting quality is multi dimensional and requires comprehensive measures. The only measure that meet this test is fundamental qualitative characteristics of accounting information (IASB 2010 and FASB 2010).

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. It is established from the study findings that demographic diversity variables of TMTs in commercial state corporations in Kenya were statistically significant with financial reporting quality measured as earnings quality, qualitative characteristics and timeliness reporting. The demographic variables that were statistically significant in explaining FRQ were; age, education, tenure, gender and functional background diversity.

LIMITATION OF THE STUDY

We acknowledge several limitations in our empirical analysis. First, our sample consists of 30 commercial state corporations and is thereby limited to commercial state corporations in Kenya. This shows that our empirical findings are not necessarily applicable to other state corporations or non-Kenyan commercial state corporations. Secondly, the limited number of top management team in commercial state corporations over ten year period (2004- 2014) may reduce the statistical power of our test. The study used secondary data, which at some point were not available due to bureaucracy involved in obtaining such data.

Thirdly, We recognize the fact that the study did not control for the industry and size effect and other firm characteristics, which may affect the current study findings. Fourthly, we were not able to exhaust all the statistical methods available to test for the robustness of the results. The study basically relied on panel regression analysis. The use of SEM and path analysis may provide different result. However, regression analysis was preferred in the study to provide for the association between the variables.

SUGGESTIONS FOR FURTHER RESEARCH

Future research work should be done in other non commercial state corporations and public benefit organizations. This will enhance the scope of the findings and level of generalization. Thus, future research could be replicated to examine the demographic diversity of top management team and quality reporting in other regulatory and

state agencies, listed companies, non governmental organizations. The same research can be carried out by bringing in other demographic characteristics like, ethnicity, culture, religion, over-confidence, etc. This will help in explaining how reporting choices and corporate voluntary disclosure affect public institutions when constituting top executives and management boards.

The 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 boards, better understandings of top management role is crucial for financial quality reporting.

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