THE IMPACT OF ADOPTING IFRS 16 ON PERFORMANCE OF COMPANIES LISTED ON THE NAIROBI SECURITIES EXCHANGE
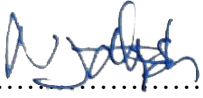
BY

JOSEPH NJALIS SHUEL

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A MASTER OF BUSINESS ADMINISTRATION DEGREE FROM THE UNIVERSITY OF NAIROBI
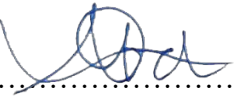
NOVEMBER 2022

DECLARATION

I declare that this research project is my original work and has not been presented for an award of a degree in any other university or institution of higher learning.

Signed……………………………………Date …29|11| 2022…………….

Name: Joseph Njalis Shuel   **Registration Number: D61/36364/2020**

This research project has been submitted for examination with my approval as the University Supervisor.

Sign…………………………………..…Date.20 – 11 – 2022 .…

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DEDICATION

To My Parents

The Late Dad, Lemung Kirenyi Ole Shuel

My Mum, Sanika Lemung Shuel

ACKNOWLEDGEMENT

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LIST OF ABBREVIATIONS AND ACRONYMS

CMA- Capital Market Authority

CDSC –Central Depository & Settlement Corporation Limited

CR- Current Ratio

DER- Debt Equity Ratio

DR- Debt Ratio

ER- Equity Ratio

EU-European Union

FDI- Foreign Direct Investment

FMA- Fund Managers Association

GSE-Ghana Stock Exchange

IAS- International Accounting Standards

IASB- International Accounting Standard Board

IASC- International Accounting Standards Committee

ICT- Information & Communication Technology

IFRS- International Financial Reporting Standard

IPOs- Initial Public Offers

ISE-Indonesia Stock Exchange

KASIB- Kenya Association of Stockbrokers & Investment Banks

MFRS-Malaysian Financial Reporting Standards

NPM- Net Profit Margin

NSE- Nairobi Securities Exchange

OCC- Operating Cash Flows Coverage

PTSM- Paired Two Sample for Means

QR- Quick Ratio

ROA- Return on Assets

ROE- Return on Equity

SMEs- Small and Medium Enterprises

SPPS- Statistical Package for Social Science

US- United States

ABSTRACT

This study was conducted to determine the impact of adopting IFRS 16 on key selected financial performance ratios of companies listed in Nairobi Securities Exchange for four successive years' period 2017-2022. The period was divided into two equal two year periods, one representing the period before the adoption of IFRS 16 (2017-2018) and the other remaining period (2019-2020) representing the post IFRS 16 adoption period. Secondary data, that are useful in computing key selected ratios relevant to the study, were collected from the audited statements of financial positions, statement of comprehensive income and statement of cash flows of the listed companies. The key selected financial ratios include return on assets, return on equity, net profit margin, current ratio, quick ratio, net operating cash flow coverage, debt ratio, equity ratio and debt to equity ratio. Shapiro walk tests was performed on the computed ratios to ascertain that they displayed normality before analysis. Descriptive analysis was carried out to get a sense of the data attributes of mean and standard deviation for all the nine ratios studied. This was followed by a two paired test for sample means to determine whether or not there are significant changes for the nine ratios before and after adoption of IFRS 16. Results for two periods did not significantly differ for all the nine ratios under study. Although all the ratios reported insignificant differences between the two periods, the debt ratio, debt to equity, net operating cash flows coverage, return on equity and quick ratio reported an increase while return on assets, net profit margin, current ratio and equity ratio reported a decrease in the post adoption period.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Zakari (2014) traced IFRS to 1st April 2001, when IASB replaced IASC. This change marked the birth of the current IFRS for firms globally in financial reporting. IFRS are globally recognised and adopted as accounting standards developed by IASB with inputs from worldwide accounting bodies and users to provide guidance and support in published financial reports.

Tran et al. (2019) observed that globalisation has accelerated IFRS adoption and that the standards have improved the reliability of financial information, enhanced investor confidence and attracted capital investments. Malo-Alain et al. (2021) observed a positive relationship between the adoption of IFRS and enhanced financial reporting and efficiency of investment decisions. Jamaani et al. (2022) concluded that IFRS are now seen as a quality certification tool, especially for IPOs in less developed economies.

Many countries in the world have embraced IFRS. This global development includes Kenya. Outa (2011) observed that Kenya substituted its local accounting standards, Kenyan Accounting Standards, with IFRS in 1998 and has since then required corporate entities, particularly those listed in NSE, to align published financial accounts with the requirements of IFRS as updated and revised from time to time.

Several theoretical frameworks underpin the adoption of IFRS in the world today. Three theories are fundamental to this study. Musa (2019) observed that the agency theory put

forward by Fama & Jensen in 1976 to explain the conflicting interests of a firm's management (agent) and shareholders (principal) is a fundamental to financial reporting. The adoption of IFRS protects against managers' self-interests.

Ramanna & Sletten (2014) put forward the economic networks theory. They concluded that the critical drivers for IFRS global adoption by countries are the net political and economic benefits of IFRSs over local standards.

The third and final theory proposed by Watt (1949) is the positive accounting theory. This theory describes and predicts the impact of a firm's choices on accounting policies and estimates. Managers have discretionary powers in choosing accounting policies which may lead to earnings management. Adoption of IFRS is expected to minimise earnings management.

Abdullahi & Abubakar (2017) observe that IFRS adoption resulted in improved reporting quality, more access to finance and more focused information in published financial statements. IFRS 16 on leases replaced IAS 17 from 1st January 2019. The application of IFRS 16: leases commenced on 1st January 2019 for all entities operating in countries that adopted IFRS to prepare and present their financial statements. Kenyan companies, particularly those listed in the NSE, have complied with this requirement. There is, however, a knowledge gap on the impact of adopting IFRS 16 on key performance measures for companies listed on NSE.

1.1.1 Adoption of IFRS 16

IFRS 16 prescribes the accounting treatment of leases for both the lessor and the lessee. Before the application of the standard, accounting for leases was based on IAS 17. In the defunct standard, classification of leases as operating and finance leases for both the lessee and lessor was permissible.

IFRS 16 defines operating leases as: 'any lease agreement that does not transfer risks and rewards of asset control to lessee'. The lessor, therefore, retains the reporting of the leased asset as part of property, plant & equipment, while the lessee pays rentals for asset usage. On the other hand, finance leases transfer rewards and risks connected with asset control to the lessee. Here, lessee has option of owning asset after expiration of duration of the lease.

Stancheva-Todorova & Velinova-Sokolova (2019) suggest that IFRS 16 introduces asymmetrical accounting treatments for the lessor and lessee. According to them, lessors retain the finance lease/operating lease dichotomy, while the same is is no longer feasible for lessees. Consequently, lessees are required to recognise, account and present in the financial statements all leases as finance leases with certain exceptions. The two categories of exceptions to finance lease reporting are that the value of the lease being below the minimum threshold of $5,000, and the duration of the lease is less than a year.

In the absence of the exceptions mentioned above, the IFRS 16 makes it mandatory for any entity involved in leasing to report all its leases as finance leases. The reports effectively ensure that all leased assets are recognised, measured, presented and disclosed

in the statement of financial position as finance leases as opposed to the previous practice where firms had discretion in determining whether to account for leased assets as finance leases or operating leases. Therefore, the presentation of leased assets as off-balance sheet assets are no longer allowed due to the adopting of IFRS 16.

1.1.2 Performance as Measured by Selected Financial Ratios

Financial ratios are quantitative metrics derived from accounting information/data from financial statements used to assess a firm's efficiency, profitability, liquidity, leverage, general performance, and financial condition. Common accounting ratios used in business include profitability, liquidity and gearing ratios. These ratios succinctly capture vital information on which investors, lenders, government agencies, regulatory authorities and policymakers base their investment and resource allocation decisions. Financial ratios are also crucial in undertaking the valuation of firms and assets and are critical imperatives in credit decisions and subsequent contracting covenants between lenders and borrowers.

The interpretation of financial ratios needs to include consideration of non-financial parameters. This consideration inherently limits and adds inadequacy to the application of ratios. Despite this critical limitation, financial ratios are still considered essential parameters in assessing firms' performance, financial position, and global liquidity situations. In this study, three categories of critical financial ratios will be the subject of the study. These categories of financial ratios include profitability, liquidity, and leverage (gearing) ratios.

Adedayo et al. (2018) define profitability as the ability of an enterprise to generate net profit from its business operations. Profitability ratios, therefore, essentially compare the net profit figure (as a numerator) with key business parameters, which include revenue, total assets and equity (as denominators) in gauging the effectiveness of a firm in generating earnings.

Liquidity ratios, on the other hand, are parameters used to capture a firm's ability to meet its short-term monetary commitments. This is achieved by comparing a firm's liquid (cash) or near-liquid assets with obligations falling due in a year. Lastly, leverage ratios are parameters used to assess a firm's debt level compared with its assets and equity. It, therefore, compares the long-term debts of a firm with total assets and shareholders' equity as well as debt with equity.

Under these three key categories of financial ratios, three ratios for each are analysed for the purpose of this study. Under the profitability ratios, the three ratios under it that will be analysed in the study are the net profit margin ratio, return on assets ratio, and return on equity ratio. Under liquidity ratios, the three ratios that will be analysed are the current ratio, acid-test (quick) ratio and net operating cash flow coverage ratio. Under the leverage (gearing) ratios, the three ratios that will be analysed are the debt ratio, equity (proprietary) ratio and the debt to equity ratio.

Therefore, nine financial ratios shall be analysed for each sampled NSE-listed firm. These ratios are good indicators of whether or not IFRS 16 adoption has impacted the reporting of financial performance, financial position and liquidity of the listed firms.

1.1.3 Adoption of IFRS 16 and Key Financial Ratios

Researchers have interrogated the impact of adopting IFRS on important performance measures like asset size and amount, financial reporting quality and other key financial parameters for listed firms at the country, regional and global levels. Several studies have indicated that, indeed, there are no meaningful changes to key financial ratios subsequent to adopting IFRS. However, a number of researchers observed significant changes in key financial ratios subsequent to adopting IFRS. The findings of some of these studies are presented below.

Ebaid (2022) observed that adopting IFRS has no meaningful impact on profitability ratios. Although the focus was not on IFRS 16, but IFRS, the study is still relevant to the adoption of IFRS 16. Ebaid (2022) indeed noted minor variations of profitability, liquidity and leverage ratios before and after the adoption of IFRS in a study of 67 Saudi firms.

However, Kimeli (2017) noted that adopting IFRS by companies greatly enhanced the level of financial reporting, predictions of markets and comparability of accounting information. Moreover, Stent et al. 92010) noted that IFRS adoption has significantly impacted common accounting ratios.

1.1.4 Companies Listed on the Nairobi Securities Exchange

Atsunyo et al. (2017) noted that the NSE was founded in 1954. Undoubtedly the NSE is the oldest and largest stock market in Sub-Saharan Africa. NSE started as a voluntary organization of stockbrokers and was registered as a society during the colonial period.

The players comprise KASIB, CDSC, FMA and listed companies with securities traded in the capital market. CMA regulates NSE activities, and all listed companies must comply with specific minimum requirements for them to be listed. One of the fundamental requirements for listing is that a company must publish annual audited financial statements and file this with CMA. Therefore, financial information of listed companies in NSE is available to the public.

A total of 63 companies were listed in the NSE between 2017 and 2020 – the period of the study. These companies represent all the crucial economic sectors of the Kenyan economy. These sectors include agriculture, motor vehicles, real estate, retail & commercial services, energy, investment services, insurance services, banking, ICT, energy and manufacturing.

1.2 Research Problem

Munene (2014) observed that leasing as a financing option has reported fast growth especially in the period prior to IFRS 16 adoption. Some of the key reasons advanced for this growth include the fact that leasing expenditures are tax allowable making it cheaper and attractive and leased assets are off- the balance sheet. In Kenya, leasing is today emerging as an alternative financing approach for corporate entities and government agencies however, its adoption is still relatively low. This is partly because of lack of appreciation of comparative advantages of leasing vis- a vis other financing options amongst the Kenyan population and in most developing economies.

Stent et al. (2010), observed that 87% of firms studied were affected by IFRS, although at varying levels. Most firms reported insignificant impacts, and several firms reported significant impacts. The impact on common financial ratios was reported as significant in this study.

Rudžionienė et al. (2022) observed that adopting IFRS led to the decline of key profitability ratios. The same was applicable to the liquidity ratios; current and quick ratios. However, they noted that the changes were insignificant, notwithstanding the decline in the ratios. On the other hand, the leverage ratios; debt to equity and equity ratios exhibited varied results, while the debt ratio reported considerable increase.

Therefore, findings from previous studies have demonstrated that adopting IFRS has had varied and mixed results for different financial ratios. Outa (2011) also noted insignificant impacts on earnings, cost of capital and accounting quality by IFRS with respect to Kenyan companies.

It is evident that past studies have emphasized on generalised effects of embracing IFRS. This study seeks to identify the specific impact of adopting IFRS 16 on key selected profitability, liquidity and leverage ratios for NSE-listed firms.

Kimeli (2017) observes that studies on the impact of adopting IFRSs in most developing countries are indeed few compared to developed nations like the US and EU member states.

1.3 Objectives of the Study

To determine the impact of adopting IFRS 16 on key selected accounting ratios for companies listed on NSE.

1.4 Value of the Study

Knowledge derived shall be important for investors, regulators, policymakers, and teaching and research institutions in Kenya and at the global level. The study will enrich and create interest for more studies on the subject in Kenya, regionally and at the global level.

This study will also inform the development of appropriate future policy interventions to increase uptake of leasing as a financing option for corporates, government agencies and individuals both in Kenya and outside the country.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter begins with a review of the theoretical framework that supports the study. A review of the factors that influence the performance of firms and past studies on the impact of adopting IFRS at the global and local levels then follows. The chapter concludes with a summary of the literature reviewed both theoretical and empirical.

2.2 Theoretical Review

The agency, economic networks and positive accounting theories providing the theoretical support for the study are reviewed herein below.

2.2.1 Agency Theory

Fama (1976) explains the often conflicting interests of a firm's management (agent) and its shareholders (principal). Managers are agents of shareholders and may pursue activities conflicting with those of shareholders, which Kimeli (2017) attributes to the non-alignment of the principal and agent's interests. The theory assumes that non-alignment of management and shareholders' interest is a default for all firms. Adopting IFRS helps align and monitor the firm's activities to minimise information asymmetry.

2.2.2 Economic Theory of Networks

Ramanna & Sletten (2014) proposed this theory to explain the increased adoption of IFRSs worldwide. Their studies concluded that the critical drivers for IFRS adoption by countries are the net political and economic benefits of IFRS over local standards. The

theory assumes that countries worldwide are influenced by economic and political interests to adopt IFRS. However, while this may be true for poor and less developed countries to attract FDI, other imperatives may be more influential. For example, Zouita et al. (2019) give a divergent view that IFRS adoption negatively impacted FDI inflows for SMEs in Algeria. Musa (2019) notes that accounting standards adoption is a political process in which critical players like the tax authority, labour unions and shareholders have significant influence. The theory is relevant to the study because it explains the increased adoption of IFRS amongst less developed economies.

2.2.3 Positive Accounting Theory

Watts & Zimmerman (1978) put forward the positive accounting theory to describe and predict a firm's choices in accounting policies and estimates. Management has discretionary powers in choosing accounting policies which may lead to earnings management. The theory assumes managers are always unscrupulous and dishonest. However, although cases of management dishonesty are there and are in some places rampant, this is not always the case. The theory is relevant in explaining behaviours of managers with discretions. Hameedi et al. (2021) note that adopting IFRS limits financial reporting alternatives for managers.

2.3 Determinants of Key Financial ratios

Abdullahi & Abubakar (2017) observed that the IFRS Conceptual Framework for Financial Reporting is key in influencing the quality of a company's financial statements. Therefore, a vital determinant of the quality of financial ratios of firms is the

operationalised, qualitative characteristics. Other relevant factors include the individual company's profitability, liquidity and leverage.

Mensah (2021) argues that operationalization of fundamental qualitative characteristics of relevance and faithful representation is a key ingredient in accounting. They are enhanced by making them understandable, comparable, verifiable and timely. The quality of performance measured by selected financial ratios depends on the company's ability to operationalise these characteristics.

There exist a linkage between profitability of a firm and its financial ratios (Agyei-Mensah, 2014). Profitability, therefore, is a factor in determining the outlook of financial ratios, particularly profitability ratios, which include return on assets and return on equity, gross and net profit margins.

Agyei-Mensah (2014) observed that there exists a linkage between liquidity of a firm and its degree of disclosures. He noted that firms with high liquidity had demonstrated a high level of disclosure, and the converse holds for those with low liquidity. However, other studies showed that firms with low liquidity have high disclosure tendencies.

 A positive relationship between a firm's debt-to-equity status and disclosure level to satisfy needs of creditors was observed by Agyei-Mensah (2014). A firm's key leverage ratios include the debt to equity ratio, the equity ratio and the debt ratio.

2.4 Empirical Studies

2.4.1 Global Studies

Ebaid (2022) examined the impact of adopting IFRS on key accounting ratios for 67 Saudi listed firms between 2014 and 2019. 2014-2016 and 2017-2019 were taken as before and after IFRS adoption periods, respectively. Information on each firm's liquidity, leverage and profitability were captured and analysed for both periods. Data were analysed using Mann-Whitney U Test to determine whether there was a significant difference in the ratios in the pre and post adoption period of IFRS. Findings indicated there was no significant difference in the ratios observed between the pre-and post-adoption period.

Górowski et al. (2022) explored the effect of adopting IFRS on key accounting ratios for 19 Polish listed firms in the energy sector between 2018 and 2019. 2018 and 2019 representing the periods before and after IFRS 16 adoption respectively. Information on liabilities and assets were captured and analysed for each firm. Data were analysed using linear regression technique. Findings indicated that adopting IFRS influenced substantially the value of assets and liabilities. The study focused on impact of IFRS on assets and liabilities values and failed to consider the impact on measures of performance.

Jibril (2019) investigated the consequence of adopting IFRS for 15 Nigeria listed banks between 2011 and 2014. He divided the period into two: 2011-2012 and 2013-2014, representing the pre and post IFRS 16 adoption periods of IFRS, respectively. Information on size, leverage, investors and market–to–book values for each listed bank was captured and analysed. Data was analysed using the linear regression technique.

Findings indicated that a significant loss recognition was reported after IFRS adoption. In a similar study in Korea, Hoon Yuk & Bin Leem (2017) noted a great improvement in earnings in the five years after IFRS adoption. Findings may not apply to other sectors owing to the unique reporting requirements of banks.

Öztürk (2016) explored the consequence of adopting IFRS 16 on accounting ratios for a Pesagus airline company in Turkey based on financial data for the year ending 2015. The study utilised the method that Imhoff, E. et al. (1991) developed to assess the impact of lease capitalization on accounting ratios. The findings demonstrate that capturing previously undisclosed operating leases led to increases in assets and liabilities of the firm. Tanase et al. (2018) agreed with this when they noted that the new IFRS 16 impacts lessees since accounting for lessors remains the same under the replaced IAS 17. Morales-Díaz & Zamora-Ramírez (2018) also noted that IFRS adoption impacted on key financial ratios (especially the leverage ratios including debt ratio and debt to equity ratio) following the capitalisation of operating leases. The study suffers the limitation of its finding lacking applicability to firms in other industries.

Santy (2016) explored how IFRS adoption affected earnings management for 23 listed banks in ISE between 2008 and 2011. Firm-specific information and data on size, leverage, investors and market–to–book values were captured and analysed. Data was analysed using regression techniques and t-tests. Findings indicated that reductions in earnings management following adoption of IFRS was not observed. However, Ooi Chee Keong et al. (2019) observed a contrary view that implementing Malaysian Financial Reporting Standards (MFRS) led to reduced cases of earnings management in listed

companies. The findings may not apply to other sectors owing to the unique reporting requirements of banks.

2.4.2   Local Studies

Chumba (2021) researched on the general effect of IFRS 16 adoption for 42 NSE companies, between 2017 and 2020. 2017-2018 and 2019-2020 representing prior to and after IFRS 16 adoption periods, respectively. Data on firm-specific information on size, IFRS 16, liquidity, leverage and profitability was collected and analysed. Data was analysed using descriptive statistics, regression analysis, variance and statistical correlation techniques. Findings concluded that adopting IFRS 16 has enhanced accounting quality. The study was general in nature and failed to recognize effect of Covid-19.

Atsunyo et al. (2017) examined the extent of IFRS compliance between Kenya and Ghana for 86 listed firms: 31 GSE-listed firms; and 50 NSE-listed firms for the period ending 31st January 2011. The study was based on information drawn from 2010 published financial statements using IFRS-anchored checklist for selected standards. The data analysis methods used in this study were t-tests and statistical correlation techniques. Findings reported an average compliance rate of 74.5% and 97.1% for Ghana and Kenya firms, respectively. The study focused on other underlying reasons for the divergence and not the impact of adoption of IFRS.

Munene (2014) investigated the effect of leasing on reported incomes of 30 NSE –listed companies between 2009 and 2013. Information on size, liquidity, leverage and operating

and finance lease was captured. SPSS version 22 and regression data analysis methods were used. Findings concluded that leasing had no effect on incomes of listed companies. Both qualitative and quantitative parameters were utilized and therefore lacked focus.

Outa (2011) examined the consequences of adopting IFRS for 32 NSE firms between 1995 and 2004. 1995-1999 and 2000-2004 representing pre and post IFRS adoption periods, respectively. Firm's specific quantitative data on earning, loss recognition and value was captured. Data was analysed through statistical correlation techniques and the Levenes test. Findings concluded that adopting IFRS did not impact positively on financial reporting quality.

Mabruk (2013) examined whether adopting IFRS by 150 out of the 421 licensed SMEs in Nairobi City County improved the quality of their accounting reports. Pertinent information on relevance, faithful representation, timeliness and relevance after adopting IFRS for each firm were captured and analysed. The study used regression statistical data analysis techniques. The findings indicated that adopting IFRS positively impacted on accounting quality. The study focused on SMEs; therefore, its applicability to large firms may not be appropriate.

2.5 Summary of Literature Review

It is evident from the review of empirical studies both globally and locally that there are gaps on the subject under investigation.

First and foremost, many have effectively failed to isolate the impact of IFRS 16/IFRS adoption from other contributing factors. For example, in Chumba (2021), Covid-19 effect on financial reporting quality, which affected performance of businesses globally following prolonged lockdowns, was not factored in.

Secondly, most of the studies were broad, covering a complete set of parameters both of qualitative and quantitative nature. These mixed studies ended up with mixed results and sometimes conflicting findings. This study addresses this by focusing exclusively on quantifiable parameters of key financial ratios and IFRS 16.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter begins by explaining the research design, population and sample selected for the purpose of the study and ends with approach adopted to capture and analyse data to achieve the study's objective.

3.2 Research Design

The study's objective is to determine the impact of adopting IFRS 16 on key accounting performance ratios for companies listed on NSE. It therefore adopted an exploratory design. The study utilized financial data and information obtained from audited accounts of listed companies to calculate the key ratios before and after the adoption of IFRS 16. The study period is for the financial periods starting 01/01/2017 and ending on or before 31/12/2018, representing the pre adoption period and starting 01/01/2019 and ending on or before 31/12/2020 representing post-adoption period. Data was analysed using paired two samples for means.

3.3 Population

63 NSE -listed companies between 2017 and 2020 constitute the research population. The study adopted a census approach given the manageable number and limited study period. The availability of audited financial statements was a crucial census requirement in addition to the continuous listing in NSE. Therefore, companies which have not filed

their annual returns were excluded from the study. The study excluded banks and insurance companies because of their unique characteristics.

3.4 Data Collection

The data and information for the financial years ending on or before 31st December 2017 and 2018 (pre-adoption of IFRS 16), beginning on or after 1st January 2019 and ending on or before 31st December 2020 (post-adoption of IFRS 16) was collected from the audited accounts of the listed companies. The collected data, covering the two financial years, was used to calculate the following nine ratios: ROA, ROE, NPM, CR, QR, OCC, DR, ER and DER for each company.

3.5 Validity and Reliability

The researcher ensured that the data collected was from duly authorised and audited annual financial statements of the listed companies.

3.6 Data Analysis

The study used descriptive statistics which involved the computation of mean and standard deviations for IFRS 16 pre-adoption and post-adoption periods and the paired two samples technique t-test to determine any correlation of both mean and standard deviation and the significance level of any disparities.

3.7 Diagnostic Tests

The study employed the Shapiro walk test to test the normality of collected data.

CHAPTER FOUR: DATA ANALYSIS, RESULT AND DISCUSSION

4.1 Introduction

The chapter presents the findings from data analysed and results thereof and a discussion of the same.

4.2 Data Collected

This research examined the impact of adopting IFRS 16 on selected financial performance ratios of companies listed on the NSE for the four years 2017-2020. The population for the study included all the 63 listed companies during the four-year period spread across 13 major sectors of the Kenyan economy.

A census approach was adopted. 18 financial institutions were excluded owing to the fact that their financial statements have unique items and their presentation requirements are different from those of non-financial firms as per the requirements of both the Banking Act and Insurance Act. This was to ensure that the financial statements of the sampled firms are to a greater extent similar in presentation and content therein. In addition, 10 more firms were left out owing to the fact that some of them were under receivership. Consequently, data was collected from 35 firms (63-28) which represents 55.55% of the population. Table 1 below provides a distribution of the companies whose data was collected based on economic sectors.

Table 1: Sectorial Distribution of the Companies Studied

Sector	Number of Companies	Percentage (%)
Agricultural	7	20
Automobiles and Accessories	1	3
Retail & Commercial Services	8	23
Construction sector	4	11
Energy sector	3	9
Investment sector	2	6
Investment services sector	1	3
Manufacturing sector	7	20
ICT Sector	1	3
Real Estate Investment Trust	1	3
Total	35	100

From the above table it is evident that companies from important sectors of the economy are represented though at varying proportions. A number of sectors have very few listed companies such as in automobiles, ICT and real estate and thus reported low percentages (3%) of the sampled firms. On the other hand, some sectors like agriculture, retail and manufacturing reported 20% and above. This is a reflection of the macroeconomic structure of Kenyan economy.

4.2.1 Shapiro walk test

Shapiro walk test was carried out for 1 year 2018-representing the pre-IFRS 16 adoption period and for 1 year 2019- representing the post IFRS 16 adoption period. Eighteen ratios computed for each company (nine before and nine after IFRS 16 adoption) were tested for normal distribution. Results indicated that data for two succeeding years representing the period of study are not normally distributed as shown in tables below.

Table 2: Shapiro walk test 2018

	Kolmogorov-Smirnov[a]			Shapiro-Walk		
	Statistic	df	Sig.	Statistic	df	Sig.
ROA	0.195	35	0.002	0.885	35	0.002
ROE	0.322	35	0.000	0.499	35	0.000
NPM	0.323	35	0.000	0.601	35	0.000
CR	0.250	35	0.000	0.758	35	0.000
QR	0.232	35	0.000	0.709	35	0.000
OCC	0.191	35	0.002	0.839	35	0.000
DR	0.131	35	0.138	0.922	35	0.016
ER	0.143	35	0.066	0.906	35	0.006
DER	0.472	35	0.000	0.269	35	0.000

It can be noted from the above result that data is not normally distributed as Sig. under the Shapiro walk Statistic for all the ratios are less than 0.05, the threshold for data to be normally distributed. Only DR and ER were above 0, with the rest reporting 0. As a result, paired two sample mean test was utilized to analyse data.

Table 3: Shapiro walk test 2019

| | Kolmogorov-Smirnov[a] | | | Shapiro-Wilk | | |
	Statistic	df	Sig.	Statistic	df	Sig.
ROA	0.338	35	0.000	0.555	35	0.000
ROE	0.415	35	0.000	0.272	35	0.000
NPM	0.295	35	0.000	0.730	35	0.000
CR	0.294	35	0.000	0.766	35	0.000
QR	0.245	35	0.000	0.722	35	0.000
OCC	0.244	35	0.000	0.863	35	0.000
DR	0.108	35	.200[*]	0.950	35	0.111
ER	0.117	35	.200[*]	0.951	35	0.126
DER	0.342	35	0.000	0.575	35	0.000

It can be noted from the above result that data is not normally distributed as Sig. under the Shapiro walk statistic for 7 out of the 9 ratios reported 0. Only DR and ER met the threshold of 0.05 and above. As a result, paired two sample mean test was utilized to analyse data.

4.3 Data Validity

To secure integrity of the data source and thus enhance data reliability and validity, only data sourced from audited reports was collected and analysed. Table 4 below presents framework adopted for data collection.

Table 4: Measurement of Key Performance

		Performance Metric	
Profitability	ROA	Profit /total assets	Audited reports
	ROE	Profit /shareholders' equity	Audited reports
	NPM	Profit /Revenue (sales)	Audited reports
Liquidity	CR	Current assets/current liabilities	Audited reports
	QR	Current assets less inventory /current liabilities	Audited reports
	OCC	Net cash flows operations/ current liabilities	Audited reports
Leverage	DR	Total liabilities/total assets	Audited reports
	ER	Shareholders' equity /total assets	Audited reports
	DER	Total liabilities/shareholders' equity	Audited reports

4.4 Descriptive Statistics

Mean and standard deviation for IFRS 16 before and after adoption of IFRS 16 for each of the nine ratios was computed. The computations are shown below.

Table 5: Table of ROA Before and After Adopting IFRS 16

Pre ROA		Post ROA	
Mean	0.034326422	Mean	-0.002067034
Standard Deviation	0.107379819	Standard Deviation	0.199904491
Count	70	Count	70
Confidence Level(95.0%)	0.025603814	Confidence Level(95.0%)	0.047665543

The mean of the ROA decreased from .03 to .002 between the two periods. The standard deviation of ROA on the other hand, reported an increase from .10 to .2 between the periods under study. This indicates a decline in ROA ratio implying that there is a general reduction in profits and or an increase in assets values for the companies under study post the adoption period.

Table 6: Table of ROE Before and After Adopting IFRS 16

Pre ROE		Post ROE	
Mean	0.00119295	Mean	-0.249771984
Standard Deviation	0.454126149	Standard Deviation	1.88981779
Count	70	Count	70
Confidence Level(95.0%)	0.108282558	Confidence Level(95.0%)	0.450611146

The mean of ROE decreased from .001 to -.25 between the two periods. The standard deviation of ROE on the other hand, reported an increase from .45 to 1.9 between the periods under study. This indicates a decline in the ROE ratio implying that there is a general reduction in profits and or an increase in equity values for the companies under study post the adoption period.

Table 7: Table of NPM Before and After Adopting IFRS 16

Pre NPM		Post NPM	
Mean	0.008871315	Mean	-0.06162431
Standard Deviation	0.467119623	Standard Deviation	0.471233209
Count	70	Count	70
Confidence Level(95.0%)	0.111380743	Confidence Level(95.0%)	0.112361592

The mean of NPM decreased from .009 to -.06 between the two periods. The standard deviation of NPM on the other hand, reported a slight increase from .46 to .47 between the periods under study. This indicates a decline in NPM ratio implying that there is a general reduction in profits and or sales for the companies under study post the adoption period. This is perhaps because of the increased expenses arising from depreciation expenses of rights of use assets (finance lease) which was previously not reported and thus reducing profits.

Table 8: Table of CR Before and After Adopting IFRS 16

Pre CR		Post CR	
Mean	2.853738921	Mean	2.757382861
Standard Deviation	3.324089788	Standard Deviation	2.951859506
Count	70	Count	70
Confidence Level(95.0%)	0.792601232	Confidence Level(95.0%)	0.703846055

The mean for the CR decreased slightly from 2.85 to 2.76 between the two periods.

Standard deviation also decreased from 3.3 to 2.95 between the periods under study. This

decline in CR ratio is possibly as a result of increase in current liabilities due to the

reporting of the current element of the now capitalised leases under current liabilities post

IFRS 16 adoption compared to the pre adoption period.

Table 9: Table of QR Before and After Adopting IFRS 16

Pre QR		Post QR	
Mean	2.097988473	Mean	2.099009773
Standard Deviation	2.689488019	Standard Deviation	2.512362079
Count	70	Count	70
Confidence Level(95.0%)	0.641285782	Confidence Level(95.0%)	0.599051592

The mean of the QR increased slightly from 2.099 to 2.10 between the two periods.

Standard deviation also decreased from 2.7 to 2.5 between the periods under study. This

indicates an increase in QR ratio possibly as a result of increase in current liabilities due

to the reporting of the current element of the now capitalised leases under current

liabilities post IFRS 16 adoption compared to the pre adoption period.

Table 10: Table of OCC Before and After Adopting IFRS 16

Pre OCC		Post OCC	
Mean	0.490120357	Mean	0.541962804
Standard Deviation	1.170771244	Standard Deviation	0.846555249
Count	70	Count	70
Confidence Level(95.0%)	0.279160549	Confidence Level(95.0%)	0.201853974

The mean of OCC increased slightly from 0.49 to 0.54 between the two periods. Standard deviation also decreased from 1.17 to 0.85 between the periods under study. This indicates an increase in OCC ratio implying that companies are becoming strict in cash collections from operations post the IFRS 16 adoption.

Table 11: Table of DR Before and After Adopting IFRS 16

Pre DR		Post DR	
Mean	0.440768699	Mean	0.460220018
Standard Deviation	0.292869832	Standard Deviation	0.290241985
Count	70	Count	70
Confidence Level(95.0%)	0.069832346	Confidence Level(95.0%)	0.069205759

The mean of the DR increased slightly from 0.44 to 0.46 between the two periods. Standard deviation also decreased from 0.292 to 0.90 between the periods under study. This indicates an increase in DR ratio between the two periods implying that perhaps as a result of adopting IFRS 16, more debt/liabilities are becoming disclosed.

Table 12: Table of ER Before and After Adopting IFRS 16

Pre ER		Post ER	
Mean	0.572047417	Mean	0.563849955
Standard Deviation	0.271994465	Standard Deviation	0.261583109
Count	70	Count	70
Confidence Level(95.0%)	0.064854791	Confidence Level(95.0%)	0.062372291

The mean of ER decreased from .57 to .56 between the two periods. The standard deviation of ER on the other hand, reported a slight decrease from .27 to .26 between the periods under study. This indicates a decline in ER ratios implying that more assets that were previously not disclosed are now disclosed.

Table 13: Table of DER Before and After Adopting IFRS 16

Pre DER		Post DER	
Mean	0.070604954	Mean	1.552596179
Standard Deviation	6.970165214	Standard Deviation	3.628792516
Count	70	Count	70
Confidence Level(95.0%)	1.66197723	Confidence Level(95.0%)	0.865255033

The mean of the DER increased significantly from 0.07 to 1.55 between the two periods. Standard deviation decreased from 6.97 to 3.63 between the periods under study. This indicates an increase in DER ratio implying that more debts/liabilities are being disclosed post IFRS 16 adoption.

4.5 Paired Two Sample for Means, Hypothesis Testing and Results

Paired two sample for means results for the nine ratios are presented as follows.

Table 14: t-Test: PTSM for ROA

	Pre ROA	*Post ROA*
Mean	0.034326422	-0.002067034
Observations	70	70
t Stat	1.567264391	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on ROA of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on ROA of listed companies on NSE. Based on the results as presented in table 14 above, ROA mean decreased from .034 to -.002. This reduction is attributed to depressed profits following adoption of IFRS 16. However, the t-stat at 1.57 is lower than t critical two-tail value at 1.99, meaning the decrease was insignificant. Therefore, the null hypothesis is accepted.

Table 15: t-Test: PTSM for ROE

	Pre ROE	*Post ROE*
		-
Mean	0.00119295	0.249771984
Observations	70	70
t Stat	1.100133141	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on ROE of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly

impacted on ROE of listed companies on NSE. Based on results presented in table 15 above, ROE mean increased from .001 to .25. This increase is attributed to the reduction of equity vis-à-vis debts/liabilities as a result of changes brought by IFRS 16 adoption. However, the t-stat at 1.10 is lower than t critical two-tail value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

Table 16: t-Test: PSTM for NPM

	Pre NPM	Post NPM
Mean	0.008871315	-0.06162431
Observations	70	70
t Stat	1.74327482	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on NPM of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on NPM of listed companies on NSE. Based on results presented in table 16 above, NPM mean decreased from .009to -.06. This reduction is attributed to depressed profits following adoption of IFRS 16. However, the t-stat at 1.74 is lower than t critical two-tail value at 1.99, meaning the decrease was insignificant. Therefore, the null hypothesis is accepted.

Table 17: t-Test: PTSM for CR

	Pre CR	Post CR
mean	2.853738921	2.757382861
observations	70	70
t Stat	0.336890721	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on CR of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on CR of listed companies on NSE. Based on results on table 17 above, CR mean slightly decreased from 2.85 to 2.75. This slight reduction is attributed to an increase of current liabilities following adoption of IFRS 16 vis- a-vis current assets. However, the t-stat at 0.34 is lower than t critical two-tail value at 1.99, meaning the decrease was insignificant. Therefore, the null hypothesis is accepted.

Table 18: t-Test: PTSM for QR

	Post QR	Pre QR
Mean	2.099009773	2.097988473
Observations	70	70
t Stat	0.004579609	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on QR of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on QR of listed companies on NSE. Based on results as presented in table 18 above, QR mean slightly increased from 2.098 to 2.099. This slight increase is attributed to an increase of current assets-mainly cash vis- a-vis current liabilities following adoption of IFRS 16. However, the t-stat at 0.005 is lower than t critical two-tail value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

Table 19: t-Test: PTSM for OCC

	Post OCC	*Pre OCC*
mean	0.541962804	0.490120357
observations	70	70
t Stat	0.416227548	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on OCC of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on OCC of listed companies on NSE. Based on results presented in table 19 above, OCC mean increased from 0.49 to 0.54. This increase is attributed to increase of net operating cash flows following IFRS 16 adoption. However, the t-stat at 0.41 is lower than t critical two-tail value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

Table 20: t-Test: PTSM for DR

	Post DR	*Pre DR*
mean	0.460220018	0.440768699
observations	70	70
t Stat	0.883456582	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on DR of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on DR of listed companies on NSE. Based on results on table 20 above, DR mean increased from 0.44 to 0.46. This increase is attributed to increase of debt/liabilities amount following IFRS 16 adoption. However, the t-stat at 0.88 is lower than t critical two-tail

value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

Table 21: t-Test: PTSM for ER

	Pre ER	Post ER
mean	0.572047417	0.563849955
observations	70	70
t Stat	0.368567564	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on ER of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on ER of listed companies on NSE. Based on results on table 21 above, ER mean decreased from 0.57 to 0.56. This decrease is attributed to increase of debt/liabilities amounts vis-à-vis equity amounts following IFRS 16 disclosures. However, the t-stat at 0.37 is lower than t critical two-tail value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

Table 22: t-Test: PTSM for DER

	Post DER	Pre DER
mean	1.552596179	0.070604954
observations	70	70
t Stat	1.515068771	
t Critical two-tail	1.994945415	

It was hypothesized that adoption of IFRS 16 had an insignificant impact on DER of listed companies on NSE. The alternative hypothesis is that IFRS 16 significantly impacted on DER of listed companies on NSE. Based on results on table 22 above, DER

mean increased from 0.07 to 1.55. This increase is attributed to disclosures following IFRS 16 adoption. However, the t-stat at 1.52 is lower than t critical two-tail value at 1.99, meaning the increase was insignificant. Therefore, the null hypothesis is accepted.

4.6 Discussion of Research Findings

It is evident from the above analysis that results for two periods insignificantly differ for all the nine financial performance ratios under study. However, some ratios indicated slight differences between the two periods.

The net profit margin ratio indicates that some reasonable variations between pre and post IFRS adoption periods existed though not significant. Indeed, $P(T<=t)$ one-tail test for NPM is 0.04287, which is less than 0.05 and in thus implying rejection of null hypothesis because the difference is significant. However, t-statistics value of 1.74 is lower but closer to the critical value test of 1.99 and therefore leading to acceptance of the null hypothesis.

ROA, NPM, CR and ER all reported a decline. The decline however was insignificant as indicated above. On the other hand, ROE, DER, QR, OCC and DR reported an increase between the two periods. The increase was, however, not significant as indicated above.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter begins by summarizing findings and conclusion arrived at. Subsequently, key recommendations on future policy interventions to increase IFRS 16 compliance levels for both public and private sector entities as well as to influence future policy developments are presented. Finally, key constraints are pointed out and suggestion for further investigations on the topic is shared.

5.2 Summary of Findings

Adoption of IFRS 16 has not impacted significantly on the parameters under investigation. However, a relatively high decrease was noted in NPM ratio under the profitability ratios. This decline though was insignificant. The results indicated mixed responses as earlier noted in previous studies. While some ratios indicated a decline between the two periods, others reported an increase between the two periods.

5.3 Conclusion

The findings demonstrate that the adoption of IFRS 16 had no major impact on key financial ratios of listed companies. This means that adoption of IFRS 16 for listed firms in Nairobi Securities Exchange insignificantly affected their profitability, liquidity and leverage performance metrics.

5.4 Recommendations

Future research should consider investigating further the aftermath of adopting IFRS 16 both for listed and unlisted firms in Kenya. It should be appreciated that leasing is an emerging financing option not only for listed and government agencies in Kenya today, but also equally for private entities and therefore merits due attention and future policy intervention.

5.5 Limitations of Study

The study had its share of limitations. One of its constraint is limited timeframe. The period of study was four years. The study would perhaps have benefited more if the study period was five years pre –adoption and the same period in the post-adoption adoption.

The other key limitation worth mentioning here is the limited number of ratios examined. This study focused only on nine key ratios and left out other important accounting metrics/ratios. Future studies should therefore consider expanding number of ratios examined to include those left out in this study.

A key limitation of the study is that the study limited itself to IFRS 16 as the only factor influencing the outcome of financial performance ratios. The study failed to factor in other variables that influence financial performance ratios of companies.

5.6 Suggestions for Further Studies

Future studies should interrogate the impact of adopting IFRS 16 for a longer period perhaps 10 years and more and involve more companies especially those in the private sector. Future studies should investigate the impact of IFRS 16 during normal economic conditions. It is good to note that Covid-19 pandemic hugely affected performance of many companies as a result of lockdowns in 2020.

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Appendices

Appendix 1: Listed Companies on the Nairobi securities Exchange 2017-2020

Listed companies on NSE 2017-2020

1. Eaagads
2. Kapchorua Tea Co.
3. Kakuzi Ltd
4. Limuru Tea Co.
5. Rea Vipingo Plantations
6. Sasini
7. Williamson Tea Kenya
8. Car and General (K)
9. Express Kenya
10. Sameer Africa Plc
11. Kenya Airways
12. Nation Media Group
13. Standard Group
14. TPS Eastern Africa (Serena)
15. Scangroup
16. Longhorn Publishers
17. Bamburi Cement
18. Crown Paints Kenya Plc
19. EA Cables
20. EA Portland Cement
21. Total Kenya
22. KenGen
23. Kenya Power & Lighting Co.
24. Olympia Capital Holdings
25. Centum Investment Co.
26. Nairobi Securities Exchange
27. B.O.C Kenya
28. British American Tobacco Kenya
29. Carbacid Investments
30. East African Breweries
31. Unga Group Ltd
32. Eveready East Africa Ltd
33. Flame Tree Group

34. Safaricom Plc
35. Stanlib Fahari I-REIT
36. Absa Bank Kenya Plc
37. Stanbic Holdings Plc
38. I & M Holdings
39. Diamond Trust Bank Kenya
40. HF Group
41. Kenya Commercial Bank
42. National Bank
43. NCBA
44. Standard Chartered
45. Equity Bank
46. Co-operative Bank
47. Bank of Kigali
48. Jubilee Holdings
49. Sanlam Kenya Plc
50. Kenya Re-Insurance Corporation
51. Liberty Kenya Holdings
52. Britam Holdings
53. CIC Insurance Group
54. TransCentury
55. Home Afrika Ltd
56. Kurwitu Ventures
57. Mumias Sugar Co. Ltd
58. Kenya Orchards Ltd
59. New Gold Issuer (RP) Ltd
60. Umeme Ltd
61. Nairobi Business Ventures Ltd
62. Deacons (East Africa) Ltd
63. Uchumi Supermarkets Ltd

Appendix 2: Companies that Formed the Population for the Study

List of Sampled Companies on NSE

1. Eaagads
2. Kapchorua Tea Co.
3. Kakuzi
4. Limuru Tea Co.
5. Rea Vipingo Plantations
6. Sasini
7. Williamson Tea Kenya
8. Car and General (K)
9. Express Kenya
10. Sameer Africa Plc
11. Kenya Airways
12. Nation Media Group
13. Standard Group
14. TPS Eastern Africa (Serena)
15. Scangroup
16. Longhorn Publishers
17. Bamburi Cement
18. Crown Paints Kenya Plc
19. E.A Cables
20. E.A Portland Cement
21. Total Kenya
22. KenGen
23. Kenya Power & Lighting Co.
24. Olympia Capital Holdings
25. Centum Investment Co.
26. Nairobi Securities Exchange
27. B.O.C Kenya

28. British American Tobacco Kenya
29. Carbacid Investments
30. East African Breweries
31. Unga Group Ltd
32. Eveready East Africa
33. Flame Tree Group
34. Safaricom Plc
35. Stanlib Fahari I-REIT