



# **ENTERPRISE RISK MANAGEMENT AND THE QUALITY OF FINANCIAL REPORTING FOR COMMERCIAL BANKS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA**

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## **Abstract**

*Quality financial reports are very important in sound investment decisions making and thus the reports need to be transparent, reliable and verifiable. However, regulators, investors, market participants and scholars have voiced concerns about the accuracy of financial reporting globally and even specifically in Kenya. Corporate governance systems like enterprise risk management are essential in making sure that organizations remain open and highly accountable. The purpose of the study was to examine the effect of enterprise risk management on quality of financial reporting in commercial banks listed at the Nairobi Securities Exchange, Kenya. The study was anchored on Enterprise Risk Management Theory. The study used descriptive survey design. The target population was 11 commercial banks listed at the Nairobi Securities Exchange, Kenya. The study adopted census method. Respondents consisted of 11 finance managers, internal auditors, company secretaries and risk and compliance officers of the 11 listed commercial banks totaling to 44 respondents. A structured questionnaire was used to obtain main data and a collection sheet to obtain the secondary data. Data was analyzed using descriptive statistics and linear regression analysis through SPSS 30. The study found out*

*that the independent variable negatively correlated with the dependent variable. Enterprise risk management ( $r=-0.635$ ) with  $p$  value of 0.000. The study recommends that regulatory bodies should encourage periodical risk management audits to evaluate the maturity and effectiveness of risk management systems within financial institutions. Central bank of Kenya and capital market authorities should periodically review and update governance and reporting regulations to reflect emerging risks and global best practices.*

*Keywords: Enterprise Risk Management, Financial Reporting Quality, Corporate Governance, Commercial Banks, Nairobi Securities Exchange*

## INTRODUCTION

The quality of financial reporting is the degree to which a company's financial information accurately shows its financial performance, financial position and cash flow position (Alsuhaibani, Houmes & Wang, 2023). It is also referred to as the extent of financial information that is relevant, reliable and easily comprehended by stakeholders noted on the financial statements of a firm (Alruwaili, Ahmed & Joshi, 2023). High-quality financial reports are necessary for investors to formulate wise and successful investment selections. To provide transparency and dependability, the financial reports must be presented in an understandable and verifiable way (IASB, 2015). Many firms utilize the reporting process to monitor corporate performance and give stakeholders like creditors, shareholders and regulators useful information. This is important for determining the company's prospective profitability, which helps in making strategic decisions and figuring out how health the company's finances are (IFRS,2018).

Corporate governance is a combination of principles and effective practices that firms can employ to realize their aims relative to shareholders (Aluoch, 2023). Corporate governance may be described as how power is exercised on corporate entities. It involves the board affairs of the company and how the company relates to shareholders (including the managers) and to other legitimate stakeholders (Tricker, 2019). The aspects of corporate governance include firm ownership, structure of board, audit committee, firm size, and enterprise risk management (Kabwe, 2023: Kisanya, Njoka, & Makori, 2024). By preventing the appointed management from using dishonest financial reporting techniques, good company governance measures can help reduce information asymmetry (Abiodun, Siyanbola & Aderibigbe, 2024). Corporate governance may affect financial reports quality (Mardessi, 2021). Therefore, it stands to reason that sound company governance will guarantee the caliber of financial reporting. The structures of

corporate governance help determine and shape the operations and controlling systems in the context of a company (Korent, Dundek & Calopa, 2014).

Recent financial scandals have raised questions about the independence and ethical standards of the accounting profession, especially with regard to the accuracy of financial statements. Examples of these scandals include Lernout and Hauspie in Belgium, Parmalat in Italy, Cadbury in England and WorldCom and Enron in the United States (Jamhuri *et al.*, 2022). The tests of the auditors and the financial analysts are critical in an agency relationship context. Nevertheless, research shows that only about half of the financial reports prepared by companies reach the appropriate level of quality (PWC, 2018). Examples of misconduct in Africa include the 2021 dismissal of First Bank of Nigeria Plc's directors in Nigeria on charges of inappropriate earnings management, which put the bank's value proposition at serious jeopardy (Adegboyega, 2021). According to a report by Thulare (2019), South Africa's African Bank and VBS Bank were liquidated in 2014 and 2018 respectively due to poor accounting and management practices. Equally in Uganda, there is a case Crane Bank in 2016, where financial statements were considered inappropriate as there was a high understatement of non-performing loans than the actual ones (Bank of Uganda, 2017).

The Capital Markets Authority (CMA) (2018) in Kenya reported that around 44 percent of listed companies in the country did not adhere to the Code of Corporate Governance 2015 (Juma, 2019). The misrepresentation of financial statements has been cited as the cause of financial distress of firms such as Mumias Sugar, Kenya Airways and Uchumi Supermarkets (Irungu, 2016). Besides, Dubai Bank was administratively wound up in 2015 and in 2016, Chase Bank was put into receivership, both after facing misrepresentation of their finances (CBK, 2017). Thus, corporate governance adherence is critical in ensuring relevance and reliability of financial reports.

Banking institutions are required to maintain confidence in society and protect depositors. To enable good governance, boards and senior management must embrace their fiduciary responsibilities which include communicating the business's strategic direction, determining risk appetite, transparent organizational processes, risk assessments and adequate capital sustenance (Matiin, Ratnawati & Riyadi, 2018). Sound governance is complementary to traditional monitoring of financial institutions, protects depositors' and investors' interests, builds public trust in the banking industry and ensures the banking sector's credibility and integrity (De Haan & Vlahu, 2016). Because banks are particularly susceptible to liquidity shocks capable of causing systematic and institutional financial instability, good governance facilitates prudential regulation and supervision thereby strengthening the performance of banks supervisors (Waemustafa & Abdullah, 2015). Enterprise risk management, one of the aspects of corporate

governance, is critical to understanding the numerous hazards that companies encounter thus assisting organizations in identifying risks that may damage their financial performance (Wang & Zhao, 2019). Kanakriyah *et al.*, (2024) discovered that the corporate risk management approach substantially affects the quality of financial reports generated by Jordanian commercial banks. The risk management in this study comprised having a risk management policy, combining risk management with internal controls and doing risk assessments on regular basis.

### Statement of the Problem

Financial reporting is the basis for making investment decisions (Aifuwa & Embale, 2019). To achieve quality financial reporting, financial reports must give a complete analysis of information related to the businesses' financial performance in terms of correctness and dependability (Uwuigbe *et al.* 2018). Thus, the value of accounting reports is directly proportional to the quality of financial reporting. However, regulators, investors, market participants and scholars have voiced concerns about the accuracy of financial reporting in the wake of scandals such as those that led in the bankruptcy of significant corporations like WorldCom, Enron and Nigerian Afribank (Jamhuri *et al.*, 2022).

Financial misreporting practices are widespread worldwide. PwC Global Economic Crime and Fraud Survey provides that four out of ten financial reports that firms present do not pass the quality test (PwC, 2018). Examples of misreporting practices for banks in Africa include the case of Afribank in Nigeria (Jamhuri *et al.*, 2022) and three Ugandan commercial banks namely Cooperative Bank, Greenland Bank and International Credit Bank that were shut down for illegal financial reporting (Kaawaase *et al.*, 2021). In Kenya, financial misrepresentation led to Dubai Bank being wound up in 2016 and Chase Bank was also brought into receivership (CBK, 2017). Aikaeli and Rashid (2015) state that in 2013, only eight banks in Kenya voluntarily revealed more than 70% of their information through annual reports, 20 disclosed between 41 and 70% of their information and three banks had disclosure ratings of less than 40%. Generally, banking breakdown emerge from poor corporate governance stemming from unethical accounting policies favouring the management (Kisanya, Njoka, & Makori, 2024). As a result, stakeholders lose money and the state economy suffers as well (Kangea, Nasieku & Muturi, 2022). Thus, because separation of control and QFR are part of the agency architecture, the significance of QFR for listed commercial banks cannot be emphasized (Jamhuri *et al.*, 2022).

Prior empirical investigations were mostly conducted in foreign countries (Akeju & Babatunde, 2017; Alsaadi *et al.*, 2021; Kabwe, 2023). For the local studies, they have focused more on non-financial firms and not specific to banks and also not on corporate governance

aspect of enterprise risk management (Jamhuri *et al.*, 2022; Kangea *et al.*, 2022 and Okeyo & Nyamute, 2024). While global literature on corporate governance and financial reporting exists, there are limited contextual studies within the Kenyan banking sector. Due to the specifics of the economic, regulatory and institutional situations in the country, it might be inappropriate to extrapolate the findings to other jurisdictions. The current study therefore sought to fill this gap by offering empirical evidence in Kenya on how Corporate Governance aspect of enterprise risk management affect the quality of financial reporting.

### **Research Objective**

To evaluate the effect of enterprise risk management on the quality of financial reporting for commercial banks listed at the Nairobi Securities Exchange, Kenya.

### **Research Hypothesis**

Enterprise risk management has no significant effect on quality of financial reporting for listed commercial banks in Kenya.

### **Scope of the Study**

The study focused on the research question about the effect of enterprise risk management on the quality of financial reporting by Kenyan commercial banks. The investigation covered nine-year period from 2016 to 2024. The time scope covered the after-adoption stage of the 2015 Kenyan Corporate Governance Code, thus allowing examination of its effect on QFR of listed commercial banks in Kenya.

### **Significance of the Study**

The study findings will help policymakers in the banking sector and practitioners (bank managers) understand the impact of enterprise risk management on the quality of financial reporting, allowing these institutions to strengthen their governance systems and procedures. It also contributes to finance theory in an innovative way by enriching current analyses of the implications of enterprise risk management on financial reporting quality, which is critical to market efficiency and investor decision-making. All investors, creditors and other stakeholders that demand quality and dependability information on financial reports to make better judgments would benefit from this study since it will educate on the components that impact dependable and high-quality financial reporting.

The study will furnish empirical evidence for regulatory bodies specifically the Central Bank of Kenya (CBK) and the Capital Market Authority (CMA) to refine existing regulatory frameworks and policies for both listed and non-listed commercial banks.

There is also the capacity by the government to understand more about banking institutions and this could be applied to change the underlying problems that majority of the institutions have. This study will also be beneficial to other scholars and researchers who would have access to evidence-based literature on enterprise risk management and quality of financial reporting. Also, internal stakeholders and employees who are dependent on good governance to provide job security and ethical corporate culture can be indirect beneficiaries of enhanced governance practices. General population and the economy in general will also benefit because banking institutions are vital to financial stability and economic growth and therefore, the quality of financial reporting can lead to a greater public trust, stability of the financial system and economic prosperity at large.

### **Limitations of the Study**

The study secondary data relied on publicly available financial reports from listed commercial banks in Kenya, which may not provide complete or up-to-date information. Some financial data were limited or difficult to access due to privacy constraints. Other respondents were also reluctant to give correct data due to fear of revealing the weaknesses in their banks.

In order to address these limitations, the study triangulated data through cross-referencing of bank data produced by the Central Bank of Kenya (CBK), Nairobi Securities Exchange and the Capital Markets Authority while also verifying the data in terms of completeness and accuracy. The research also utilized a purposive sample technique to concentrate on banks that routinely publish key governance and financial data, especially listed banks, which are subject to strict reporting obligations. The respondents were also assured of confidentiality of information obtained.

## **REVIEW OF LITERATURE**

### **Theoretical Review**

The research variables were based on Enterprise Risk Management Theory. Enterprise Risk Management Theory offers a multidimensional view of comprehending, managing, monitoring and managing the entire risk exposure of a given organization. According to COSO definition, ERM is a process put in place by the directors, management and other people on the entity, performed in the process of making strategy and performed throughout the enterprise,

shaped to detect the events that can happen and affect the entity and to manage the risk so that it will fall within its risk appetite (COSO, 2017).

ERM theory attaches to risk management as strategic planning and decision-making tools in operations and in turn enhances better financial management and governance. As applied to financial reporting, proper implementation of ERM will improve internal controls and compliance and thus minimize the risk of misstatements in financial reporting, fraud reporting or omissions. Moreover, research including Beasley, Clune, and Hermanson (2005), suggests that firms that have mature ERM systems are more likely to have better quality of financial reporting because of increased risk awareness, improved coordination of internal auditing and increased accountability. However, Arena, Arnaboldi, and Azzone (2010) claim that the effectiveness of ERM is difficult to assess because it does not have standardized measures.

In the banking industry, where levels of risk are intrinsically high because of credit, operational, market and regulatory risks, ERM can be instrumental in the protection of the integrity of financial disclosures. Intense risk management mechanisms are also useful in developing investor confidence and compliance with regulations that commercial banks are concerned with. Hoyt and Liebenberg (2011) discovered a positive relation between adoption of ERM and value of firm which is in partly due to improved risk-based financial reporting practices. ERM theory fitted the objective of this research by demonstrating the way proper risk management systems are implemented to promote high quality financial reporting in commercial banks. When risks are dealt with in a holistic manner using models like COSO ERM, banks are more equipped to make proper and complete disclosure of financial information in a timely manner. This is especially important to the Kenyan banking industry where economic uncertainty and regulatory oversight is essential for risk oversight and reporting integrity.

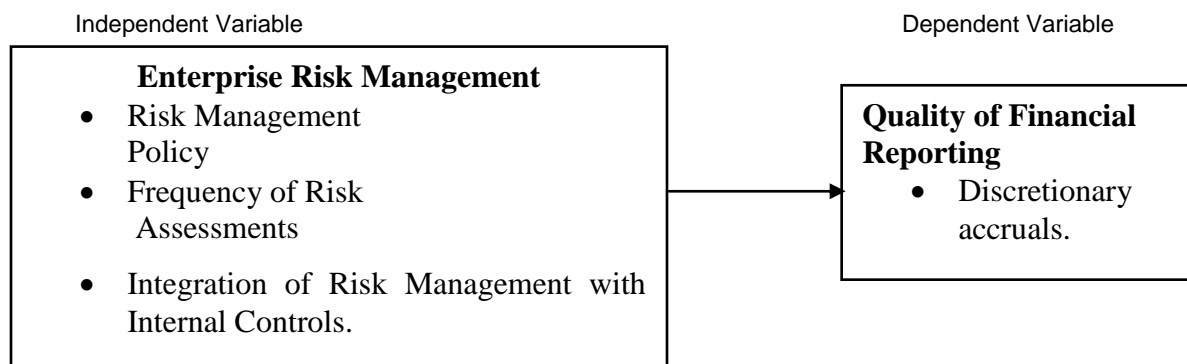
### **Empirical Review**

To determine the effects of adopting a corporate risk management model on the QFR of commercial banks in Jordan, Kanakriyah et al. (2024) conducted empirical research, with a focus on two aspects of QFR, that is, faithful representation and relevance. The research population comprised of thirteen Jordanian commercial banks. Data collection was via a random sample of 234 employees of the supervisory and financial departments of these organizations. The study outcomes support the hypothesis that the QFR within Jordanian banks is significantly influenced by risk management measures. Unlike the present research, which used discretionary accruals, the methodology of that study was focused on two important points namely faithful depiction and relevance.

Marzuki et al. (2024) evaluated the relationship between risk management plans and possible distortion of financial reporting in Malaysia. The sample of the study consisted of 257 firms with data gathered for 2012-17. The study found that there exists a high correlation between the risk management activities at any point in the disclosure process and the risk of fraud within financial reporting. But the research concluded that there was no meaningful contribution of risk- management committee in reducing the risk of false financial statements. This study was on a foreign setting.

Novatiani, Afiah, and Sumantri (2022) explored risk management and other variables that contribute to avoiding misleading financial reporting by Indonesian state-owned enterprises. The goal of the study was to provide a broad overview of the role that risk management, internal auditing and implementation of good corporate governance (GCG) have on the financial reporting of Indonesian state-owned enterprises (SOE) quality. In the study, there were 360 respondents and 90 state-owned firms. The results show that financial reporting is impacted by risk management, internal audit activity efficacy and GCG utilization. But the study was also conducted in a foreign country.

Figure 1: Conceptual Framework



## METHODOLOGY

### Research Design

This study employed a descriptive research design. Descriptive research focus on delineating the features of group or people (Kothari, 2014). The descriptive design aligns with the purpose of identifying the existing correlations among the variables (Creswell, 2021). Thus, it was suitable in this research since the study aimed to ascertain the existing correlations between enterprise risk management and QFR as reported by listed commercial banks in Kenya.

## Target Population

The study population encompassed all eleven commercial banks listed at the Nairobi Securities Exchange (CBK, 2024) as enumerated in appendix IV. The target population was finance managers, internal auditors, company secretaries, and risk and compliance officers of these listed commercial banks due to their expertise in corporate governance and financial reporting fields.

## Sample and Sampling Techniques

Kenya has a total of eleven listed commercial banks. Census approach was employed to incorporate all the eleven listed commercial banks into the sample, as this number is reasonably small and manageable in accordance with (Mugenda & Mugenda, 2013). Purposive sampling technique was used to select a finance manager, an internal auditor, a company secretary and a risk and compliance officer of each of the eleven banks resulting in 44 respondents.

## Data Collection Instruments

The study used primary and secondary data. For primary data collection, the researcher and the two study assistants administered questionnaires to the participants, allowed them two weeks period to answer the questions and followed up for responses through phone calls. The questionnaire was self-designed.

The content validity of the questionnaire was achieved by involving supervisors and inviting experts in the area of banking and finance to review and enhance the questions further to ensure that they are closely related to the objectives of the study. The use of face validity was taken into consideration through pre-testing the questionnaire using a finance manager, an internal auditor, a company secretary and a risk and compliance officer from family bank, to understand the level of clarity of the questions and to determine any possible ambiguities.

The Cronbach alpha was used to predict the reliability of the questionnaire with a target alpha of 0.70 or above which was attained. Also, a register was maintained for recording the responses received. On the other hand, questionnaires that were not finished within the allotted two weeks were not included in the data analysis. Secondary data was extracted out of the published banking reports for the period 2016 to 2024 using secondary data collection sheet.

## Empirical Model

Linear regression analysis was used to investigate the causal-effect relationship between dependent variable and independent variables (Darlington & Hayes, 2017). The statistical significance between the variables was tested at a 95% confidence level using R-square. The following details apply to the simple linear regression model used in this study:

$$Y = \beta_0 + \beta_1 X_1 + \epsilon$$

Where:

Y = Quality of Financial Reporting

$\beta_0$  = Constant term (y intercept)

$\beta_1$  = Regression Coefficients

$X_1$  = Enterprise Risk Management

$\epsilon$  = Error term (other factors not included in the model)

## Data Analysis

Collected data was edited and cleaned to ensure accuracy and completeness and then items coded and scored. Robustness check specifically sensitivity analyses, was used to assess the impact of missing data on results. Missing data was handled using imputation method which involves replacing missing values with estimated values (Schafer & Graham, 2002). The Statistical Package for the Social Sciences (SPSS v. 30) software was used in data processing and analysis to guarantee accuracy and reliability of results (Field, 2013). The data was analysed using descriptive and inferential statistics. Descriptive statistics included mean, standard deviation, and frequency, whereas inferential statistics included linear regression analysis.

## RESULTS AND FINDINGS

The study analysis and results as outlined in the research objective are presented in this section. Structured questionnaires were used for primary data collection from key employees in the sampled commercial banks. For secondary data, it was elicited from banks audited financial reports for years 2016 to 2024. The findings presented in this section are guided by descriptive, correlation and regression analysis.

## Descriptive Statistics

Table 1 shows the descriptive statistics of the variables under study. The results show the mean and standard deviation of enterprise risk management.

Table 1: Descriptive Statistics of Enterprise Risk Management

Statement	N	Mean	Std.
			Deviation
The bank has in place an established and functioning risk management policy.	32	4.4063	.71208
The risk management committee actively oversees risks related to financial reporting.	32	3.8750	.79312
Risk assessment frequency is sufficient to identify and address emerging financial reporting risks.	32	3.9375	.84003
Risk management practices are properly integrated with the bank's internal control systems.	32	4.1250	.79312
The integration of ERM with internal controls improves the accuracy of financial reporting.	32	4.0938	.73438
Enterprise risk management enhances the reliability and timeliness of financial reports	32	3.9375	.71561
Valid N (listwise)	32		

Table 1 results reveals that the perception on ERM practices is overall positive at the surveyed banks, though there are certain differences between the dimensions. The measure of the statement that the bank has in place an established and functioning risk management policy had the highest mean score of 4. 4063 (SD = 0.71208) indicating existence of strong consent that the banks have formal and functional risk management policy in place. This is an underlying element in ERM that is essential in the definition of the climate and framework of proper risk management and control. With a mean of 3. 9375 (SD = 0.84003), the statement-Risk assessment frequency is sufficient to detect and respond to emerging financial reporting risks appeared to be agreed to by participants indicating that the source of financial reporting risks is adequately looked at during the frequency of the risk assessments conducted. This is a practice that strengthens the performance of the banks in terms of presenting quality and timely financial statements. That ERM enhances the reliability and timeliness of financial report was rated 3. 9375 (SD = 0.71561) and that applicability of ERM to the internal controls increased the accuracy of financial reporting had a mean of 4. 0938 (SD = 0.73438). The scores indicate that there is consensus that ERM, when properly combined with the internal controls, has a favorable influence on the reliability, accuracy and on-time delivery of the financial reports. The response to the statement that the risk management committee actively monitors risks associated with financial reporting had a mean score of 3.8750 (SD = 0.79312), indicating that the overall

perception concerning the nature of the oversight role of the risk committee was agreeable but there might be some differences across institutions as to the extent to which the risk committee undertakes the oversight role with active monitoring.

The statement that risk management practices were properly incorporated with the internal control systems of the bank had a mean 4.1250 (SD = 0.79312). Though still on the high side, this still implies that there may be no uniformity in the integration of ERM with the internal control systems, implying an area that needs an improvement. In conclusion, existence of formal policies, a risk assessment process, and embedment with internal controls are perceived to bring about the improved quality of financial disclosures not only with respect to its accuracy but also timeliness.

### Correlation Analysis

Results of Pearson correlation analysis on the relationship between QFR and enterprise risk management are shown in this section. The aim was to determine the direction and intensity of the connections between these variables. Table 2 shows the outcome.

Table 2: Correlation between enterprise risk management and Quality of Financial Reporting

		QFR	ERM
QFR	Pearson Correlation	1	
	Sig. (2-tailed)		
ERM	Pearson Correlation	-.635**	1
	Sig. (2-tailed)	.000	

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

The results of the analysis can be described as statistical correlations between the independent variable and QFR. There exists a reasonably moderate correlation between enterprise risk management and QFR which is negative (-0.635,  $p = 0.000$ ), implying that poor assessment of ERM practices including the lack of integration of risk or risk supervision will have an adverse impact on QFR.

### Regression Analysis

To ascertain how enterprise risk management might affect quality of financial reporting, the study conducted regression analysis. Tables 3, 4 and 5 respectively exhibit Model summary, ANOVA and coefficient results respectively.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.635 <sup>a</sup>	.404	.384	42048.51247

a. Predictors: (Constant), ERM

Table 3 shows an adjusted R square of 0.384, which means enterprise risk management explains 38.4% of changes in QFR.

Table 4: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	35881576830.459	1	35881576830.459	20.294	.000 <sup>b</sup>
	Residual	53042322039.541	30	1768077401.318		
	Total	88923898870.000	31			

a. Dependent Variable: QFR

b. Predictors: (Constant), ERM

Table 4 displays a p value of  $0.000 < 0.05$  and a F statistic of 20.294. This suggests that the study model's ability to predict the dependent variable was statistically significant (good fit). It demonstrates that enterprise risk management significantly predicts QFR in the banks.

Table 5: *Regression Coefficients*

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	463464.102	87095.479		5.321	.000
	ERM	-96227.656	21360.666	-.635	-4.505	.000

a. Dependent Variable: QFR

Table 5 shows that enterprise risk management had significant effect on QFR (with p value of 0.000 which is  $< 0.05$ ).

## CONCLUSION

The study's objective was to evaluate the effect of enterprise risk management on the quality of financial reporting for listed commercial banks, Kenya. The correlation results show that there exists a reasonably moderate correlation between ERM and QFR which is negative. Further, regression analysis provides that enterprise risk management negatively and substantially effect on QFR. The study thus concludes that enterprise risk management (ERM)

has a significant negative effect on discretionary accruals, indicating a positive contribution to financial reporting quality. Banks that have embedded ERM models with formal risk policies, assessments and embedded with internal controls were more likely to generate a timely and accurate financial report. This highlights the importance of risk management in good financial disclosures particularly in the banking industry where there is exposure to high financial, regulatory and operational risks.

## RECOMMENDATIONS

The management must incorporate ERM practices in the operations and culture of an organization. These include frequent risk evaluations, well-documented policies on risk and integration of ERM and financial reporting and internal controls to ensure disclosure is on time and with accuracy. Stricter regulations on the implementation of ERM on listed banks should be enforced by regulatory bodies including compulsory ERM auditing and stakeholder reporting. These need to be in line with global best practices as COSO ERM. Results of the study justify the role of ERM as an important governance mechanism. Future theoretical models should therefore directly incorporate ERM in the models that examine the quality of financial reporting.

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