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EFFECT OF ACCURACY OF ACCRUALS ON THE MARKET VALUE OF FORMAL MANUFACTURING FIRMS IN KENYA

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ABSTRACT

Misstatement of accruals is a major hindrance on the credibility of financial statements prepared by companies across the globe. When accruals are not correct, the information conveyed by the financial statements end misleading those relying on them for crucial decisions. The objective of this study was to investigate the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya. The relationship between accuracy of accruals and market value was moderated by firm size. Signaling effect theory was used in supporting this study. This study adopted the mixed research design. Stratified random sampling technique was used in sample size determination. The study used both primary and secondary data. The p-value of 0.000 which was less than 0.05 confirmed that accuracy of accruals has a significant positive effect on the market value of the formal manufacturing firms in Kenya. The p value of 0.484 which was greater than 0.05 on the moderated relationship model, confirmed that firm size has no significant moderating effect on the relationship between accuracy of accruals and market value. The researcher recommends that formal manufacturing firms should focus on strengthening their accuracy of accruals reporting strategies, because they significantly affect their market value.

KEYWORDS: Accuracy of Accruals; Market Value; Interest Rate Volatility; Financial Reporting

INTRODUCTION

Proper financial reporting plays a vital role in fostering effective decision-making within businesses and the broader financial ecosystem (Opanyi & Omare, 2022). When financial reports are accurate, transparent, and reliable, they provide stakeholders with a clear and comprehensive view of a company's financial health and operational performance (Gathogo, 2017). This clarity is paramount for investors who rely on financial statements to assess the viability and potential return on their investments (Ibrahim, 2017). Similarly, creditors use this information to determine a company's creditworthiness and ability to meet debt obligations (Kalui & Garang, 2018). Regulators also depend

on high-quality financial reporting to ensure compliance with financial laws and standards, thereby maintaining market integrity and protecting public interest (Velte, 2022). Accurate financial information therefore is imperative in allowing businesses to make informed strategic decisions (Naciti, 2019). One of the aspects which is key in warranting financial reporting quality is accuracy of accruals (Dechow et al, 2020).

Accuracy of accruals measurement is a vital measure in which should be maintained by any company wishing to report quality and reliable financial information to its stakeholders (Williams & Anderson, 2021). Accrual accounting involves recognizing revenues and expenses when they are incurred, regardless of when cash transactions occur (Nguyen & Tran, 2021). Accurate accruals ensure that financial statements reflect the true economic activities of a company, providing stakeholders with reliable information for decision-making (Dechow et al, 2020). Accuracy in accrual reporting has an impact on earnings quality, and consequently the market value of a firm (Dubois & Martin, 2021). Conversely, inaccurate accruals can lead to significant distortions in reported earnings, potentially misleading stakeholders about a company's financial health (Francis et al, 2019). This distortion can have far-reaching implications, including erroneous investment decisions and misallocation of resources. The imperious of accuracy of accruals in communicating the true and fair view of companies' financial status and influencing investors decisions, motivated this study which seeks to investigate the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya.

STATEMENT OF THE PROBLEM

Statistics from the Kenya National Bureau of Statistics (KNBS) indicates that the market value of the formal manufacturing companies in Kenya with reference to their contribution to the country's Gross Domestic Product (GDP) declined from 8.6% in 2019 to 7.6% in 2023. (Kenya National Bureau of Statistics, 2024). The suboptimal market value of the formal manufacturing companies in Kenya could be attributed to poor reporting of accruals.

Studies conducted around the globe indicate that accuracy of accruals in financial reporting impact companies positively (Williams & Anderson, 2021). This can be visualized from the studies by Nguyen and Tran (2021) in Canada, Dubois and Martin (2021) in France as well as Nkosi and Dlamini (2020) in South Africa. Some of the previous studies were conducted outside Kenya, used different methodologies than the ones adopted in this study, and were carried out in different industries other than the formal manufacturing firms in Kenya. These scenarios brought about the contextual, conceptual and the methodological gaps which this current study sought to constrict.

This current research study was therefore undertaken so as to address the problem of poor market

value in the formal manufacturing firms in Kenya as well as constrict the identified research gaps. This study therefore undertook to conduct research in order to unravel the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya.

Objective of the study

- i. To investigate the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya.
- ii. To investigate the moderating effect of firm size on the relationship between accuracy of accruals and the market value of formal manufacturing firms in Kenya.

Hypothesis

- H₀₁: Accuracy of Accruals has no significant effect on the market value of formal manufacturing firms in Kenya
- H₀₂: Firm size has no significant moderating effect on the relationship between accuracy of accruals and the market value of formal manufacturing firms in Kenya.

THEORETICAL REVIEW

Signaling Effect Theory

The theory was first introduced by Nobel laureates Michael Spence and George Akerlof in the early 1970s and has since been widely applied in various fields, including finance and economics (Civera et al, 2019). The theory has proven useful in understanding how individuals or firms use signaling strategies to reduce information asymmetry and convey their quality or intentions to others (Yasar et al, 2020). When one party possesses more or better information than another, the signaling effect theory suggests that individuals or entities will take specific actions or send signals to reveal hidden or private information (Civera et al, 2019). By sending signals, individuals or firms aim to reduce the uncertainty and information asymmetry between themselves and others (Hatami & Firoozi, 2019).

One of the primary strengths of this theory is its ability to explain how information asymmetry can be reduced, thereby improving market efficiency (Jones & Smith, 2023). The theory is applicable across various contexts, from initial public offerings (IPOs) to mergers and acquisitions (M&As) (Jones & Smith, 2023). Furthermore, the signaling effects theory has been instrumental in developing regulatory policies aimed at enhancing market transparency and protecting investors, (Yasar et al, 2020). The theory also encourages firms to engage in more transparent and honest communication with their stakeholders, thus, fostering a culture of trust and accountability (Hatami & Firoozi, 2019). The relevance of this theory in enhancing transparency, honesty and the conveyance of credible information so as to circumvent information asymmetry, informed its close study so as to support the variables used in this research study.

Conceptual Framework

A conceptual framework is a diagrammatic representation of the relationship between the independent and the dependent variables under study (Patel & Patel, 2019). The dependent variable of this study was market value whereas the independent variable was accuracy of accruals. The relationship between the dependent and the independent variable was moderated by firm size. The conceptual framework used in this study was given in figure 1.

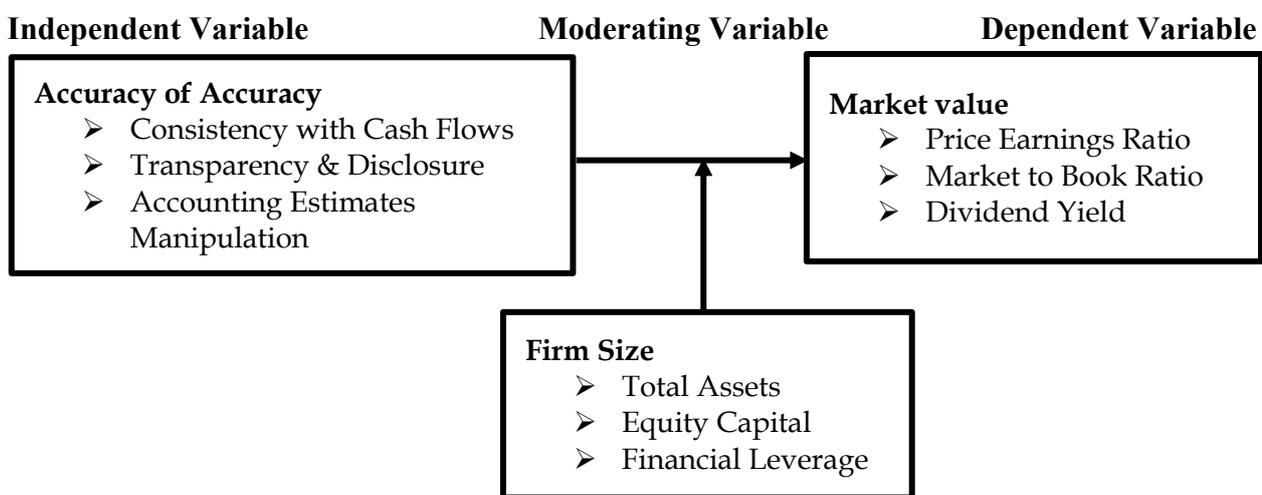


Figure 1: Conceptual framework

Empirical Review and Critique of the Research Gap

In Australia, Williams and Anderson (2021) reported a significant effect of accuracy of accruals on the performance of companies in the mining industry. The researchers used the cross-sectional research design in their study. Williams and Anderson used secondary data in their study. In Canada, Nguyen and Tran (2021) investigated the relationship between financial reporting quality and financial distress. The scholars used the logistic regression analysis on a sample of distressed firms. The researchers concluded that firms with higher financial reporting quality such as accuracy of accruals practices experience limited financial distress. Nguyen and Tran recommended that firms should enhance their reporting standards in order to ensure financial stability. In South Africa, a study by Nkosi and Dlamini (2020) examined the impact of financial reporting quality on small and medium enterprises (SMEs). The researchers adopted the mixed research design in their study. After data analysis, the scholars reported that accuracy of accruals significantly enhances the market value of SMEs in South Africa. Nkosi and Dlamini demonstrated that accurate financial reports enable better access to financing and enhancement of business credibility. In France, Dubois and Martin (2021) explored the effect of financial reporting quality on innovation performance in technology firms. The researchers used panel data and reported that better financial reporting quality such as accuracy of

accruals positively influences the innovation performance of technology firms in France. The researchers used the cross-sectional research design in their study.

The reviewed studies brought about the methodological, conceptual and the contextual research gaps which this current study sought to address. This is because some of the studies were done outside Kenya, used different methodologies and conceptualized their variables in a different manner from this current research study. This study therefore, sought to constrict the identified research gaps by investigating the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya.

RESEARCH METHODOLOGY

This study adopted the mixed research design. The population of study comprised of the 1,105 formal manufacturing firms in Kenya, whereas the sample size was 294 firms. The stratified random sampling technique was used in selecting the 294 units of analysis out of the population. The study used both primary and secondary data. The collected data was analyzed via the Statistical Package for Social Sciences version 23. Descriptive statistics, correlation statistics as well as the regression statistics were generated in this study. Diagnostic tests were conducted on the data before running the simple linear regression model. The regression coefficients generated were used in testing the hypothesis at 0.05 level of significance and decision made on whether to reject or fail to reject the null hypothesis. The regression model guiding this study was formulated in the following manner.

$$Y = \beta_0 + \beta_1 X_1 + \epsilon \dots \dots \dots \text{Equation 1}$$

Where:

Y: Represented Market Value

X₁: Represented Accuracy of Accruals

The moderated regression model was espoused in determining the moderation effect of the firm size on the relationship between prudential accounting and market value of the formal manufacturing firms in Kenya. The moderated regression model was specifically employed in testing H₀₂. The moderated regression model tests whether the prediction of a dependent variable (Y), from an independent variable (X) varies across levels of a moderating variable (Z). The moderated regression model comprised of two stages, the first stage involved estimating the main effect of the predictor variable (X) and the hypothesized moderator (Z) as shown in equation (2)

$$Y = \beta_0 + \beta_1 X_1 + \beta_z Z + \epsilon \dots \dots \dots \text{Equation 2}$$

Where:

Z: Represented the moderating variable (Firm size)

β_Z : Represented the beta coefficient of the moderating variable

The second stage encompassed adding the interaction of the moderating variable so as to obtain equation (3).

$$Y = \beta_0 + \beta_1 X_1 + \beta_{1Z} X_1 * Z + \epsilon \dots \dots \dots \text{Equation 3}$$

Where: β_{1Z} : Represented the beta coefficients of the product term ($X * Z$)

RESEARCH FINDINGS AND DISCUSSION

Diagnostic Tests

Test for Normality

For the successful running of the linear regression model, the data ought to be distributed normally (Creswell, 2018). Normality of the data is confirmed when the normal p value statistics from the Shapiro Wilk test are greater than 0.05 (Nayak & Singh, 2021). Table 1 presented a p value of 0.094 for the market value variable, 0.221 for the accuracy of accruals variable and a p value of 0.086 for the firm size moderating variable. The p-values from the Shapiro Wilk test for the variables under study which were greater than 0.05 confirmed that the data set for this study was normally distributed.

Table 1: Normality Test Results

Variables	Shapiro-Wilk		
	Statistic	df	Sig.
Market value	.991	260	.094
Accuracy of Accruals	.993	260	.221
Firm Size (Z)	.990	260	.086

Test for Linearity

This study used the scatter plots in testing for linearity. Linearity in a data set is confirmed when the scatter plots cluster around a straight line (Nayak & Singh, 2021). The results for the test for linearity in this study were generated and presented in figure 2 and 3.

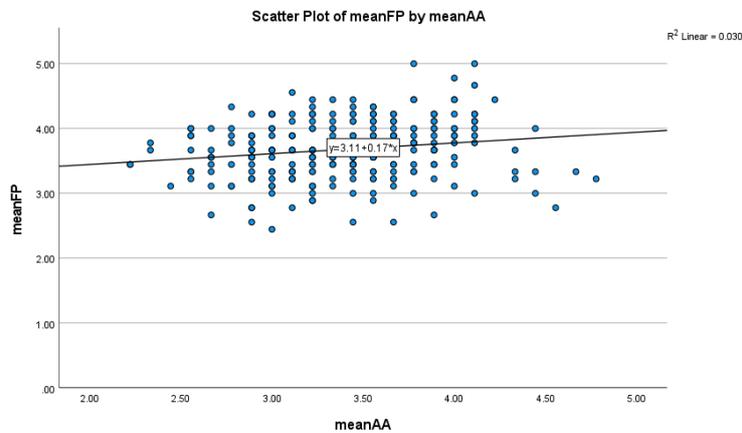


Figure 2: Scatterplot of Accuracy of Accruals and Market value

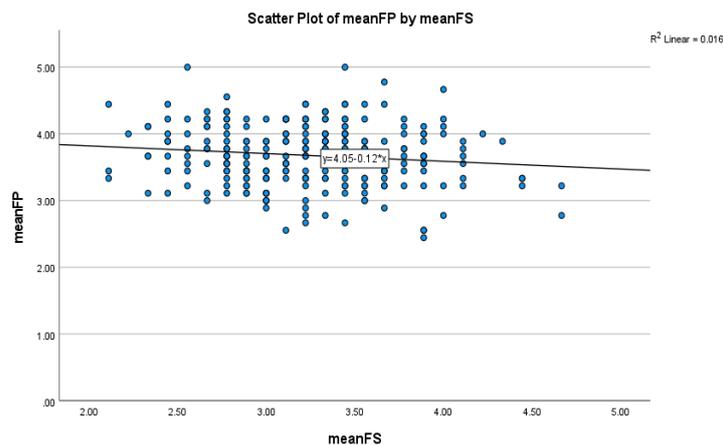


Figure 3: Scatterplot of Firm Size and Market value

Descriptive Test Results

The descriptive statistics for this study were generated using SPSS and the results tabulated in table 2.

Table 2: Descriptive Statistics

	N	Mean	Std. Dev.
Accuracy of Accruals	260	3.95	.715
Market Value	260	3.68	.784
Firm Size (Z)	260	3.24	1.037

Table 2 showed that the overall mean score values for the accuracy of accruals, market value and firm

size variables was 3.95, 3.68 and 3.24 respectively. These outcomes confirmed the general agreement by the respondents that the formal manufacturing firms are implementing accuracy of accruals practices in their quest to improve their market value. The standard deviation statistics value of 0.715, 0.784 and 1.037 for the accuracy of accruals, market value and firm size variables which were less than the mean statistics confirmed that the data for these variables was well distributed around the central tendency.

Pearson’s Correlation Analysis Results

The Pearson’s correlation analysis statistics were generated and presented in table 3

Table 3: Pearson’s correlation analysis results

		Market Valu	Accuracy of Accruals	Firm Size
Market Value	Pearson	1		
	Correlation			
	Sig. (2-tailed)	.000		
	N	260		
Accuracy of Accruals	Pearson	.173*	1	
	Correlation			
	Sig. (2-tailed)	.005	.000	
	N	260	260	
Firm Size	Pearson	-.125*	.532*	1
	Correlation			
	Sig. (2-tailed)	.043	.000	.000
	N	260	260	260

The pearson’s correaltion analysis statistics presented in table 3 indicated a weeak positive relationship of 0.173 between accuracy of accruals and market value, which was significant at 0.005 level (2-tailed). The outcomes indicated that for every unit increase in accuracy of accruals, market value increases by 0.173 units. The correlation coefficient for firm size and market value was a weak inverse relationship of -0.125.

Regression Analysis Results

This section comprised of table 4 for the model summary, table 5 for ANOVA, and table 6 for the regression coefficients.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.551 ^a	.304	.281	.38332

a. Predictors: (Constant), Accuracy of Accruals, Z_{AA}

b. Dependent Variable: Market value

The R-square of 0.304 from the model summary in table 4 indicated that over 30.4% of the variability of the dependent variable could be explained by the independent variables. The R-square results indicated that the model was a good fit.

Table 5: ANOVA Results

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	16.079	8	2.010	13.679	.000
Residual	36.881	251	.147		
Total	52.960	259			

a. Predictors: (Constant), Accuracy of Accruals, Z_{AA}

b. Dependent Variable: Market value

The significant F test statistic of 0.000 in table 5 indicated that the model was fit and statistically significant, thus paving way for the successful running of the regression model.

Table 6: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	2.294	.290			7.896	.000
Accuracy of Accruals	.295	.072	.308		4.088	.000
Z _{AA}	-.025	.036	-.067		-0.701	.484

a. Dependent Variable: Market value

The findings in table 6, informed the fitting of regression model as shown in equation 4.

$$Y = 2.294 + 0.295X_1 - 0.025_{1Z}X_1 * Z \dots\dots\dots \text{Equation 4}$$

Where,

Y: is the Market value

X₁: is accuracy of accruals

X₁*Z: is the interaction between accuracy of accruals and firm size (the moderator)

Hypothesis Testing

The p-value statistics from the regression model in table 6 were used in testing the hypothesis at 0.05 level of significance. The results for the hypotheses testing were given in table 7.

Table 7: Hypothesis Testing

Hypothesis Statement	P-value	Decision Rule
H₀₂: Accuracy of Accruals has no significant effect on the market value of the formal manufacturing firms in Kenya.	.000	Reject H₀₁ , Since P-value <0.05
H₀₂: Firm size has no significant moderating effect on the relationship between accuracy of accruals and market value of the formal manufacturing firms in Kenya.	.484	Fail to Reject H₀₂ , Since P-value >0.05

Discussion of Key Findings

The objective of the study was to investigate the effect of accuracy of accruals on the market value of formal manufacturing firms in Kenya. The study further examined the moderating effect firm size on the relationship between accuracy of accruals and market value of formal manufacturing firms in Kenya. The Statistical Package for Social Sciences (SPSS) version 23 was used in data analysis and the findings were presented in tables, chats and plots of distribution. The hypothesis testing in table 7 led to the rejection of H₀₁, since the p value of .000 was less than .05. The rejection H₀₁, indicated that accuracy of accruals has a significant positive effect on the market value of formal manufacturing firms in Kenya. The findings were similar to the findings of Williams and Anderson (2021) who reported a significant positive effect of accuracy of accruals on the performance of companies in the mining industry in Australia. The findings were also in agreement with the findings of Nkosi and Dlamini (2020) who reported a positive significant effect of accuracy of accruals on the performance

of small and medium enterprises in South Africa. Similar findings were also reported by Nguyen and Tran (2021), who reported that accuracy of accruals significantly reduces firms' financial distress in Canada.

The hypothesis testing for the moderation effect led to the failure to reject H_{02} . The failure to reject of H_{02} indicated that firm size has no significant moderating effect on the relationship between accuracy of accruals and the market value of the formal manufacturing firms in Kenya.

CONCLUSION

Based on the findings from this study, the researcher concludes that accuracy of accruals has a significant positive effect on the market value of formal manufacturing firms in Kenya. This conclusion was drawn from the statistical analysis which revealed a positive correlation between accuracy of accruals and the market value of formal manufacturing firms in Kenya. The rejection of H_{01} further substantiated the significant positive effect of accuracy of accruals on the market value of formal manufacturing firm in Kenya. With reference to the moderation effect, the researcher concludes that firm size has no significant moderating effect on relationship between accuracy of accruals and the market value of formal manufacturing firms in Kenya.

RECOMMENDATIONS

The study therefore, recommends that the formal manufacturing firms in Kenya should embrace accuracy of accruals practices because it positively affects their market value. Additionally, it is recommended that the formal manufacturing firms should prioritize continuous evaluation of their accuracy of accruals practices so as to stay abreast of competition and ensure that the techniques remain effective and relevant. The researcher also recommends that other variables such as the interest rate volatility should be explored so as to further study the moderation effect between accuracy of accruals and the market value of formal manufacturing firms in Kenya.

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