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# EARNINGS MANAGEMENT AND FINANCIAL REPORTING QUALITY OF LISTED COMMERCIAL BANKS IN KENYA

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**Abstract:**
Earnings management is described as a technique or procedure used by accountants in conformity with the guidelines of Generally Accepted Accounting Principles (GAAP) to adjust earnings or change the reported figure to present more favorable financial information. It has existed for decades but has lately acquired prominence owing to corporate scandals. Therefore, this study aimed to evaluate the effect of earnings management on the financial reporting quality of commercial banks in Kenya. The specific objectives of the study included; evaluating the effects of revenue management on financial reporting quality of commercial banks in Kenya, to examine the effects of asset management on financial reporting quality of commercial banks in Kenya, to assess the effects of debt management on financial reporting quality of commercial banks in Kenya, to examine the effects of expenses management on financial reporting quality of commercial banks in Kenya and, to examine the moderating effect of corporate governance on the relationship between earnings management and financial reporting quality of commercial banks in Kenya. The study was anchored on positive accounting theory, agency theory and legitimacy theory. The study adopted an ex-post facto panel-based quantitative research design. The study's target population was all listed commercial banks in Kenya. A secondary data collection sheet was used to collect study data. Panel data was analyzed using descriptive and inferential statistics. The study

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employed panel data regression analysis to examine the effect of earnings management practices and corporate governance on financial reporting quality among listed commercial banks in Kenya. Diagnostic tests confirmed that the data satisfied the assumptions of regression analysis, and the Hausman specification test indicated that the random effects model was the most appropriate for the study. The study found that earnings management practices, revenue, asset, debt, and expense management, negatively and significantly affect financial reporting quality in listed commercial banks in Kenya. Regression results show revenue management ($\beta = -0.4089$, $p < 0.001$), asset management ($\beta = -0.3719$, $p < 0.001$), debt management ($\beta = -0.2857$, $p < 0.001$), and expense management ($\beta = -0.2140$, $p < 0.001$) all reduce reporting quality. Corporate governance positively influences financial reporting quality ($\beta = 0.6127$, $p = 0.001$) and moderates the effect of earnings management, with the interaction term significantly buffering its negative impact ($\beta = 0.4796$, $p < 0.003$). The overall model is statistically significant (Wald $\chi^2 = 323.47$, $p < 0.001$) and explains 63.15% of the variation in reporting quality. These findings suggest that while earnings management undermines transparency, strong corporate governance mitigates its adverse effects, enhancing the quality of financial reporting. This study provided insights into how earnings management affects the reliability of financial statements in Kenyan commercial banks. The findings may help the Central Bank of Kenya strengthen transparency policies and curb manipulative reporting. For bank managers and accountants, it offers guidance on ethical reporting, IFRS compliance, and building investor confidence.

**JEL:** M40, M41, M42, M48, M49, H83, G32.

**Keywords:** earnings management, financial reporting quality, revenue management, asset management, debt management, and expense management

## 1. Introduction

Financial Reporting Quality (FRQ) stands at the core of corporate transparency, accountability, and market efficiency. It represents the degree to which financial statements convey a firm's true economic performance and position (Mesioye & Bakare, 2024). Historically, FRQ evolved with the expansion of global capital markets in the early 20th century, as investors demanded reliable, comparable, and decision-useful information. This demand catalyzed the development of standardized accounting frameworks from Generally Accepted Accounting Principles (GAAP) to the International Financial Reporting Standards (IFRS), intended to enhance consistency and credibility in corporate disclosures (Eshiet *et al*., 2023).

Financial reporting quality (FRQ) comprises several interrelated dimensions that determine the extent to which financial statements faithfully represent a firm's underlying economic reality. High-quality reporting is grounded in faithful representation, meaning information must be complete, neutral, and free from material error. It must also demonstrate relevance by providing predictive and confirmatory value that supports sound economic decision-making. Comparability and consistency enable users to evaluate performance across time and across firms through the uniform application of accounting policies (Jaff, Al-Kake, & Hamawandy, 2021).

In addition, verifiability ensures that reported figures can be independently substantiated by auditors, thereby limiting subjective managerial discretion. Effective reporting must also exhibit timeliness, such that information is provided while still useful to stakeholders, and understandability, ensuring disclosures are presented clearly for knowledgeable users. Collectively, these dimensions enhance transparency, reduce information asymmetry, and strengthen stakeholder confidence in financial statements (Jaff, Al-Kake, & Hamawandy, 2021).

Mesioye and Bakare (2024) further argue that financial reporting quality is the extent to which financial statements provide accurate, dependable, and relevant information about a company's financial situation and performance. High-quality financial reports are transparent, thorough, and follow applicable accounting rules, such as International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP). Quality financial reporting allows stakeholders to make informed decisions and builds trust between the company and its investors, contributing to market stability (Etukenyin, Akpan, & Amoren, 2025).

The quality of financial reports has received massive attention due to various scandals arising from earnings management and misrepresentation of financial reports in recent years. Large companies such as Enron and Cadbury had collapsed, and investors were misled as a result of poor information quality occasioned by earnings management (Etukenyin, Akpan, & Amoren, 2025). Financial reporting quality has always been of interest among regulatory bodies, shareholders, researchers and the accounting profession itself. This is because financial reporting has been a principal means of communicating financial information to outside users, and the financial report itself is used in assessing the firm's economic performance and condition in the quest to monitor management's actions and assist in making economic decisions (Zulu, 2023). This implies that when earnings management is mishandled may affect the quality of financial information, hence misleading the users of the financial information.

However, Earnings Management (EM) has persisted as a systemic threat to FRQ. EM is defined as the deliberate manipulation of accounting figures within acceptable reporting frameworks to achieve predetermined financial objectives (Healy & Wahlen, 1999; Bisogno & Donatella, 2022). The practice emerged as early as the 20th century, when firms sought to influence investor perception and meet lending requirements (Dechow & Skinner, 2000). Over time, it evolved into sophisticated accrual-based and real activity manipulations, reflecting both managerial opportunism and the pressures of market expectations (Mellado & Saona, 2020; Assenso-Okofo, Jahangir-Ali, & Ahmed, 2021).

Alhadab and Al-Own (2017) argued that earnings management was a technique or procedure used by accountants in conformity with the guidelines of Generally Accepted Accounting Principles (GAAP) to adjust earnings or change the reported figure to present more favorable financial information. Bisogno and Donatella (2022) further added that earnings management is the deliberate manipulation of financial statements by management to achieve desired financial results. It involves using accounting methods, judgments, or operational decisions to influence reported earnings, often to meet targets, maintain investor confidence, or comply with contractual requirements (Lara, Osma, & Penalva, 2020).

Earnings management can be split into two types: accrual-based management and real activity manipulation. Accrual-based earnings management comprises adjustments to accounting to improve earnings baselines, which should be corrected in future periods without impacting firm cash flows (Mellado & Saona, 2020). Manipulation of real activities might impact a company's cash flow by altering typical business processes. Manipulation of real operations can lower a firm's value by negatively impacting future cash flows. This approach has a long-term impact and is commonly used by managers in underdeveloped countries to increase reported earnings (Assenso-Okofo, Jahangir-Ali, & Ahmed, 2021).

Further, Chen *et al.* (2021) added that accrual-based earnings management involves adjusting accounting policies or estimates such as depreciation, provisions for bad debts, and inventory valuation to alter reported profits and, consequently, perceived performance. Real activities manipulation, on the other hand, entails altering actual business operations such as overproducing to reduce unit costs, cutting essential research and development, or timing revenue and expense recognition to create a temporary improvement in financial performance.

Debbianita, Kuang, and Hoetama (2024) underline that earnings management is not necessarily outright fraud but rather the use of accounting techniques, estimates, and judgments allowed under accounting standards to present financial performance in a way that benefits the organization or its stakeholders. Managers may engage in earnings management to smooth income fluctuations, meet analysts' forecasts, comply with debt covenants, influence stock prices, or achieve performance-based bonuses (Habib, Ranasinghe, Wu, Biswas, & Ahmad, 2022).

Although earnings management may be viewed as a strategic tool to portray strong financial performance and maintain shareholder confidence, it carries significant risks. Excessive or unethical manipulation distorts the true financial performance of a firm, undermines transparency, misleads investors, weakens corporate governance, and ultimately erodes organizational credibility and long-term profitability (Palacios-Manzano, Gras-Gil, & Santos-Jaen, 2021).

High-profile corporate scandals worldwide, such as Enron and WorldCom, illustrate the destructive potential of aggressive earnings management practices. Consequently, regulators, auditors, and stakeholders emphasize strict compliance with financial reporting standards, enhanced oversight, and strong corporate governance to minimize the negative effects of earnings management (Rajeevan & Ajward, 2020).

Earnings management in commercial banks refers to the deliberate adjustment of financial statements by bank managers to present a desired picture of profitability, stability, or financial health. Unlike non-financial firms, banks operate in a highly regulated environment where earnings play a critical role in signaling financial soundness to regulators, investors, depositors, and other stakeholders (Chaity & Islam, 2022). Because banks are custodians of public funds and their stability directly influences the economy, the management of earnings in this sector carries unique implications (Biswas, Bhattacharya, Sadarangani, & Jin, 2022).

Commercial banks often engage in earnings management to meet regulatory requirements, avoid penalties, comply with capital adequacy ratios, or maintain public confidence. For instance, they may smooth earnings to reduce volatility and appear less risky to depositors and regulators (Tran, Lam, & Luu, 2020). Common techniques include adjusting loan loss provisions (LLPs), timing the recognition of interest income, or restructuring non-performing loans to minimize their impact on reported earnings. Loan loss provisions, in particular, are one of the most widely used tools in banks, since managers have discretion in estimating future credit losses. By underestimating or overestimating LLPs, banks can shift earnings between periods to manage profitability (Mangala & Singla, 2023).

The incentives for earnings management in banks are diverse. Managers may seek to influence stock prices, secure performance-based bonuses, attract more investors, or enhance the institution's competitive position. In some cases, banks may use it to avoid breaching debt covenants or to comply with central bank regulations. However, excessive manipulation can undermine transparency, distort financial performance, mislead stakeholders, and contribute to financial instability. For example, during global financial crises, weak earnings management practices in banks amplified risks by masking true asset quality (Le, Nguyen, & Tran, 2021).

Global accounting scandals such as Enron, WorldCom, and Lehman Brothers exposed the devastating consequences of EM on FRQ, investor trust, and market stability. These events prompted regulatory overhauls, including the Sarbanes–Oxley Act (2002) and enhanced IFRS oversight (Rajeevan & Ajward, 2020). The banking sector, in particular, remains vulnerable due to reliance on managerial judgment in loan loss provisioning, asset valuation, and fair value estimation, areas susceptible to earnings manipulation (Mangala & Singla, 2023).

Globally, in India, a report by Chatterjee and Rakshit (2023) indicated that earnings management directly affects corporate governance, as it involves intentional manipulation of accounting figures to achieve specific objectives rather than presenting the true financial position of a firm. When managers use discretionary practices such as altering loan loss provisions, timing revenue recognition, or deferring expenses, the reported earnings may no longer faithfully reflect underlying performance. This compromises the reliability, transparency, and comparability of financial statements, making it harder for investors, regulators, and other stakeholders to make informed decisions. Ultimately, earnings management weakens trust in reported information and increases the risk of financial misrepresentation.

In Malaysia, Al-Zaqeba *et al*. (2022) found that earnings management tactics primarily result in a misrepresentation of a company's genuine financial condition. The failure of global corporations was caused by an imbalance in funding arrangements, an inability to satisfy outstanding promises, a lack of supervisory procedures, and financial and administrative misconduct in audit firms. The lack of internal control systems for managers' actions has led to increased interest in corporate governance in recent years. Investors and stakeholders lost faith in the integrity and dependability of financial accounts due to a series of company failures.

In Vietnam, a report by Nguyen, Kim, and Ali (2024) indicated that earnings management has garnered public attention following recent corporate scandals in the country. Vien Dong Pharmaceutical Joint Stock Company (DVD), previously regarded as one of the most promising entities in the pharmaceutical sector, unexpectedly encountered bankruptcy in 2011, despite reporting an earnings growth rate of 325 percent in 2009, when DVD held the top position in the industry. Ineffective corporate governance methods, including the disproportionate concentration of authority among senior executives, a dysfunctional board structure characterized by conflicts of interest, and a merely symbolic supervisory board, were held accountable for enabling DVD management to deceive its stakeholders.

Regionally, in Nigeria, there has been a demand for enhanced regulation of markets, as accountants and auditors increasingly exceed permissible boundaries within the accounting profession. Additionally, the region encountered its own iteration of the Enron crisis with the Cadbury PLC affair, wherein the company's senior management manipulated financial records to conceal specific deficiencies and other unethical transactions (Okafor, Ezeagba, & Onyali, 2018).

In South Africa, it was indicated that obscure characteristics of earnings management practices impacted auditors' effectiveness and subjected them to potential litigation and reputational harm. Management may intentionally choose unobservable real earnings management techniques, while auditors identify that the predominant accrual management techniques pertain to revenue manipulation, business combination accounting, measurement of intangibles, fixed assets, investments, reserves, and lease recognition. Auditors are more inclined to demand restatements of earnings management practices when managers are suspected of misinterpreting and misapplying principles within International Financial Reporting rules (IFRS), rather than merely structuring transactions to adhere to specific rules.

In Kenya, there have been collapses and closures of specific companies suspected of participating in real earnings management; for example, Uchumi Supermarket, Mumias Sugar Company, and banks such as Dubai Bank, Imperial Bank, and most recently, Chase Bank, which was placed under receivership. The rise in profits management strategies has resulted in corporations issuing profit warnings. The NSE attributes these profit alerts to causes such as a depreciated local currency, accounting fraud, and heightened competition (Wangui & Simiyu, 2017).

In Kenya, the commercial banking sector has transformed substantially since liberalization in the 1990s. The shift toward IFRS compliance and digital integration has strengthened disclosure regimes; however, recurring cases of loan misclassification, under-provisioning, and profit overstatement highlight persistent weaknesses in reporting integrity (KIPPRA, 2024; Central Bank, 2024). High-profile collapses such as Imperial Bank, Chase Bank, and Dubai Bank have exposed governance lapses and managerial discretion, signaling that mere IFRS compliance does not equate to transparent reporting (Wangui & Simiyu, 2017).

Empirical literature underscores that corporate governance (CG) serves as a moderating mechanism between EM and FRQ (Alharasis *et al.*, 2025). Governance structures comprise independent boards, effective audit committees, and transparent oversight, which enhance accountability and mitigate opportunistic financial behavior (Palacios-Manzano *et al.*, 2021; Habib *et al.*, 2022)). Conversely, weak governance amplifies the risk of distorted disclosures and erodes stakeholder confidence (Al-Zaqeba *et al.*, 2022).

In the context of Kenyan-listed commercial banks, where financial stability underpins public trust and economic resilience, the integrity of financial reporting is paramount. Banks occupy a systemic role as custodians of public deposits and key conduits of monetary policy. Thus, earnings manipulation, whether through loan loss provisions, asset revaluation, or timing of income recognition, undermines both institutional credibility and macroeconomic stability (Chaity & Islam, 2022; Tran, Lam, & Luu, 2020).

Against this backdrop, this study investigates the relationship between Earnings Management and Financial Reporting Quality of listed commercial banks in Kenya, with Corporate Governance as a moderating construct. It situates the inquiry within both global and local contexts, bridging theoretical perspectives and empirical realities. The goal is to provide actionable insights into how governance mechanisms can align managerial discretion with principles of financial transparency, accountability, and sustainable performance within Kenya’s banking ecosystem.

## 2. Statement of Problem

Financial reporting quality (FRQ) is central to institutional credibility and market confidence. Yet, across global markets, earnings management (EM) continues to obscure the true financial performance of firms. While existing literature consistently associates EM with diminished FRQ (Rajeevan & Ajward, 2020), empirical findings remain contextually inconsistent, largely shaped by differences in regulation, governance, and market discipline (Bisogno & Donatella, 2022). In Kenya, the commercial banking sector has experienced recurring financial reporting failures despite compliance with International Financial Reporting Standards (IFRS) and Central Bank of Kenya (CBK) oversight. High-profile collapses such as Imperial Bank, Chase Bank, and Dubai Bank exposed deep-seated issues of earnings manipulation, loan misclassification, and governance lapses. For instance, commercial banks recorded losses of over KSH 1.5 billion to cyber fraud, and this was not recorded in the books of accounts, showing clear manipulation of financial statements (KIPPRA, 2024; Central Bank, 2024). These cases underscore how aggressive earnings management can erode transparency, distort reported performance, and compromise stakeholder trust. Empirical research on the interaction between earnings management and financial reporting quality in Kenya's banking industry remains limited. Most prior studies have either focused on non-financial firms or applied cross-sectional designs, overlooking longitudinal patterns and the moderating influence of corporate governance mechanisms, a key determinant of transparency and managerial accountability. This study therefore addresses a critical research gap: the lack of empirical evidence on how earnings management practices influence financial reporting quality among listed commercial banks in Kenya, and how corporate governance moderates this relationship. Understanding this nexus is essential to strengthening regulatory oversight, enhancing disclosure credibility, and restoring stakeholder confidence in Kenya's financial system.

## 2. Main Objective of the Study

To evaluate the effect of earnings management on financial reporting quality in commercial banks in Kenya.

### 2.1 Specific Objectives of the Study

1) To evaluate the effects of revenue management on the financial reporting quality of listed commercial banks in Kenya.
2) To examine the effects of asset management on the financial reporting quality of listed commercial banks in Kenya.
3) To assess the effects of debt management on the financial reporting quality of listed commercial banks in Kenya.
4) To examine the effects of expense management on the financial reporting quality of listed commercial banks in Kenya.
5) To evaluate the moderating effects of corporate governance on the relationship between earnings management and financial reporting quality of listed commercial banks in Kenya

### 2.2 Study Hypotheses

**$H_{01}$:** Revenue management has no significant effect on the financial reporting quality of commercial banks in Kenya.

**$H_{02}$:** Asset management has no significant effect on the financial reporting quality of commercial banks in Kenya.

**$H_{02}$:** Debt management has no significant effect on the financial reporting quality of commercial banks in Kenya.

**$H_{04}$:** Expenses management has no significant effect on the financial reporting quality of commercial banks in Kenya.

**H$_{04}$:** Corporate governance has no significant moderating effect on the relationship between earnings management and financial reporting quality of listed commercial banks in Kenya.

## 3. Literature Review

### 3.1 Positive Accounting Theory

Positive Accounting Theory (PAT), introduced by Watts and Zimmerman (1986), provides a predictive and explanatory framework for understanding managerial behavior in accounting policy choices. The theory posits that managers act rationally to maximize their personal and organizational benefits, often selecting accounting methods that best serve their interests within existing contractual, regulatory, and political environments. Unlike normative theories, which prescribe ideal accounting practices, PAT focuses on explaining and forecasting the actual accounting choices managers make in response to incentives and constraints (Kabir, 2010). In this study, Agency Theory underpins the analysis by positing that managers' opportunistic accounting choices compromise the credibility of reported earnings. By integrating corporate governance as a moderating variable, the study aligns with Agency Theory's prescription that effective monitoring can constrain opportunistic financial behavior, thereby enhancing financial reporting quality in listed commercial banks in Kenya.

### 3.2 Legitimacy Theory

Legitimacy Theory, advanced by Dowling and Pfeiffer (1975), posits that an organization's survival depends on the congruence between its actions and the value systems of the society in which it operates. Legitimacy is achieved when corporate behavior aligns with social norms, expectations, and regulatory standards, creating a "social license to operate." When a misalignment occurs, either real or perceived, the firm faces legitimacy threats such as loss of stakeholder confidence, reputational damage, or regulatory sanctions (Bitektine & Haack, 2015). In this context, organizations often engage in strategic disclosures, communication, or symbolic actions to restore or maintain legitimacy (Zelditch-Jr, 2018). In this study, legitimacy theory anchors the link between earnings management and financial reporting quality, suggesting that the pursuit of legitimacy through managed disclosures often compromises the authenticity of reported information. It also implies that maintaining legitimacy through authentic, transparent, and high-quality financial reporting is essential for the sustainable credibility of listed commercial banks in Kenya.

### 3.3 Agency Theory

Agency theory, developed by Jensen and Meckling (1976), explains the inherent conflict of interest between principals (shareholders) and agents (managers) arising from the separation of ownership and control. The theory assumes that managers, entrusted with the stewardship of organizational resources, may not always act in the best interests of shareholders. Instead, they may pursue self-serving objectives such as maximizing bonuses, enhancing career prospects, or concealing poor performance through opportunistic financial reporting. This divergence in interests gives rise to agency costs, including monitoring expenses, bonding costs, and residual losses (Fama & Jensen, 1983). In this study, Agency Theory underpins the analysis by positing that managers' opportunistic accounting choices compromise the credibility of reported earnings. By integrating corporate governance as a moderating variable, the study aligns with Agency Theory's prescription that effective monitoring can constrain opportunistic financial behavior, thereby enhancing financial reporting quality in listed commercial banks in Kenya.

### 3.4 Conceptual Framework

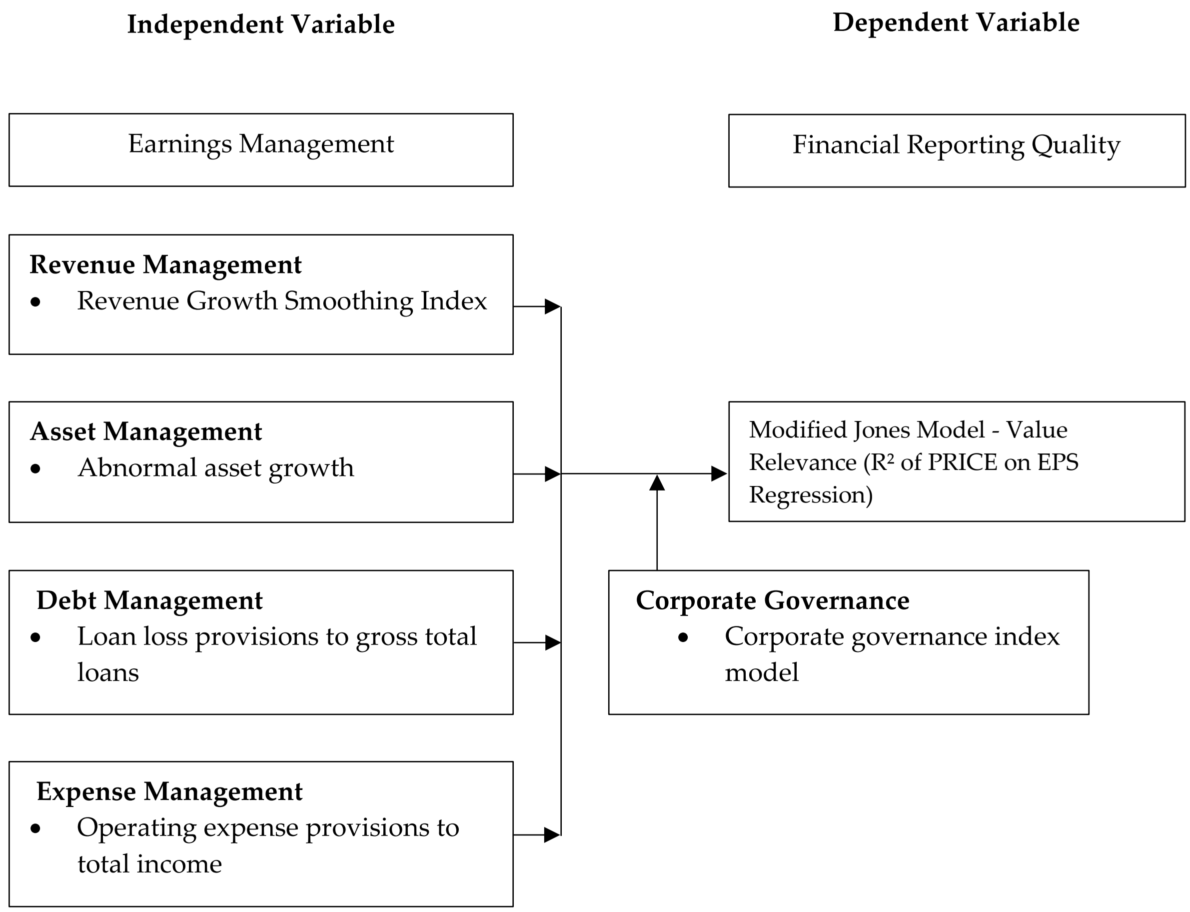


**Figure 1:** Conceptual Framework

### 2.5 Empirical Literature Review

#### 2.5.1 Revenue Management and Financial Reporting Quality

Revenue management and financial reporting quality are closely interconnected through managerial discretion in recognizing, timing, and classifying revenue transactions. In the banking sector, this relationship is particularly important because the primary revenue streams—interest income, service charges, and commissions—are highly sensitive to pricing policies, credit risk assessment, and macroeconomic conditions. Effective revenue management enables banks to optimize income streams while ensuring that reported financial performance reflects the underlying economic reality of the institution. However, excessive managerial discretion in revenue recognition may create opportunities for earnings manipulation, thereby distorting financial statements and undermining transparency, reliability, and comparability. Accounting frameworks such as the International Financial Reporting Standard (IFRS) 15 therefore emphasize strict guidelines for recognizing and measuring revenue to ensure that financial reports faithfully represent the economic substance of transactions.

Empirical studies present varied perspectives on the implications of revenue management for financial outcomes. Nancy-Seelye (2022) examined revenue management strategies among U.S. commercial banks during the COVID-19 pandemic and found that adaptive pricing strategies and adjustments in loan product portfolios significantly influenced financial performance. The study emphasized that revenue management is not limited to pricing decisions but also involves dynamic product allocation and portfolio adjustments aimed at optimizing financial returns in uncertain environments. While these strategies enhance operational resilience, they also expand managerial discretion in revenue reporting, increasing the risk of opportunistic earnings manipulation during periods of financial pressure.

Similarly, Natesan, Thakur, Dutta, and Tiwari (2023) analyzed revenue management in the Indian banking sector using dynamic and static pricing models for mortgage products. Their findings indicated that interest rate sensitivity and default risk significantly influence pricing decisions and ultimately shape both profitability and perceived financial stability. This suggests that revenue management decisions can have important implications not only for operational performance but also for the quality and credibility of financial reporting.

Although a substantial portion of the revenue management literature originates from sectors such as hospitality and service industries, these studies provide important conceptual insights applicable to banking. Murimi, Wadongo, and Olielo (2021) and Herath et al. (2023) demonstrated that structured revenue management systems supported by data analytics, demand forecasting, and pricing optimization significantly enhance profitability while improving reporting transparency. These studies suggest that when revenue management is anchored in systematic and data-driven processes, it contributes positively to both operational efficiency and the credibility of financial disclosures.

Organizational and technological capabilities also play a critical role in shaping the outcomes of revenue management practices. Nyaga (2023) highlighted that managerial competence, technological infrastructure, and alignment between revenue strategies and organizational objectives determine whether revenue management generates genuine performance improvements or facilitates earnings smoothing. Similarly, Onyango and Nguthi (2025) observed that modern revenue management practices increasingly integrate advanced analytics, predictive modeling, and customer behavior analysis. While these tools improve strategic decision-making and market responsiveness, they also introduce greater subjectivity into revenue recognition processes, particularly when governance mechanisms and monitoring structures are weak.

From a theoretical perspective, the relationship between revenue management and financial reporting quality can be explained through agency theory, positive accounting theory, and legitimacy theory. Agency theory suggests that managers may exploit information asymmetry to manipulate revenue recognition in order to maximize personal benefits such as compensation or job security. Positive accounting theory further posits that managers select accounting methods that maximize their own utility, particularly when faced with incentives related to performance evaluation or contractual obligations. Legitimacy theory also provides insight by suggesting that organizations may manipulate reported financial outcomes to maintain legitimacy with regulators, investors, and the public.

Despite the growing body of literature, a notable gap remains regarding how revenue management practices influence financial reporting quality within emerging banking markets, particularly in the context of listed commercial banks operating under evolving regulatory environments. Most existing studies focus on operational performance or profitability outcomes rather than the implications for financial reporting integrity. Consequently, this study conceptualizes revenue management as a key channel through which managerial discretion influences financial reporting quality among listed commercial banks in Kenya. By empirically examining this relationship, the study contributes to the literature by clarifying whether revenue management practices enhance genuine financial performance or facilitate earnings manipulation that undermines the credibility of financial reports.

### 2.5.2 Asset Management and Financial Reporting Quality

Asset management and financial reporting quality are closely interconnected through the processes of valuation, utilization, and disclosure of a bank's asset portfolio. In commercial banks, assets, particularly loans and advances, constitute the primary income-generating component and reflect managerial prudence, credit discipline, and risk management effectiveness. Efficient asset management ensures optimal allocation of financial resources, accurate assessment of credit risk, and timely recognition of loan impairments. These practices enhance operational performance while ensuring that reported financial outcomes accurately represent the bank's underlying economic position. However, excessive managerial discretion in asset valuation and classification may create opportunities for earnings manipulation through practices such as aggressive lending, delayed recognition of non-performing loans (NPLs), or discretionary provisioning. Such practices distort reported earnings, weaken transparency, and ultimately compromise the reliability and credibility of financial statements.

Empirical literature demonstrates the importance of asset management in shaping bank performance, though its implications for financial reporting quality remain less explored. Owusu and Alhassan (2021) examined asset–liability management in Ghanaian banks and found that profitability was strongly associated with balance sheet management practices. Their findings indicated that banks with higher returns on assets often maintained higher liability costs, suggesting a strategic balancing of asset returns and funding structures. While the study established the importance of asset allocation in enhancing profitability, it did not explicitly evaluate how these practices influence financial reporting integrity. Consequently, although efficient asset management supports sustainable earnings, it may also create opportunities for discretionary accounting adjustments that obscure the true quality of reported financial outcomes.

Similarly, Al-Sadi and Al-Mamouri (2022) reported that effective asset management significantly improves bank profitability, particularly through maintaining asset quality and minimizing non-performing loans. Their results showed that prudent oversight of asset portfolios enhances both return on assets and return on equity. However, the absence of governance and reporting variables limited the ability to determine whether improved performance reflected genuine operational efficiency or managerial discretion in asset valuation and provisioning. This suggests that asset management efficiency must be examined alongside governance and disclosure mechanisms to determine its true implications for financial reporting quality.

Supporting these findings, Purba and Bimantara (2020) identified a positive relationship between asset management efficiency and firm financial performance using panel data across multiple firms. Their analysis confirmed that effective asset utilization contributes to improved profitability and liquidity over time. Nevertheless, the study did not incorporate governance or disclosure dimensions, which are critical in assessing the credibility of financial reporting. In banking contexts, where loan valuation and impairment provisions significantly influence reported earnings, the absence of strong oversight mechanisms may allow managers to manipulate asset-related accounting estimates to smooth income or achieve targeted financial outcomes.

Beyond banking-specific research, broader asset management literature also highlights the role of strategic asset governance in organizational performance and transparency. Maletič et al. (2020) emphasized that strategic alignment, performance measurement, and risk management are fundamental elements of effective physical asset management. Their findings indicate that structured asset management systems enhance operational reliability and sustainability. Although the study relied on self-reported data and focused primarily on operational performance, its conclusions suggest that systematic asset governance reduces information asymmetry and supports credible financial reporting.

Further evidence is provided by Gajisan and Gatawa (2023), who linked asset management efficiency to firm performance and market valuation among publicly listed Philippine firms. Their findings demonstrated that efficient asset utilization enhances profitability and investor confidence, measured through both accounting-based and market-based indicators. However, the study did not examine governance or disclosure frameworks, limiting its ability to explain how asset management practices influence financial reporting quality. In banking institutions, where asset valuation and loan impairment recognition significantly affect earnings, weak disclosure frameworks may enable managers to misrepresent asset quality, thereby undermining financial reporting transparency.

Complementary insights are offered by Syaifudin, Ritchi, and Avianti (2020), who examined determinants of asset management effectiveness in the public sector and identified leadership quality, managerial competence, and internal controls as critical factors. Their findings suggest that institutional discipline and transparency significantly influence the accuracy and reliability of asset reporting. Although the study focused on government entities, its implications are equally relevant to the banking sector, where strong governance and internal control systems are necessary to ensure fair asset valuation and credible financial disclosure.

Synthesizing across the literature, a consistent pattern emerges: effective asset management enhances operational efficiency and financial performance, yet its true reflection in financial statements depends on the strength of governance mechanisms, transparency in disclosure, and adherence to accounting standards. In banking institutions, asset management lies at the intersection of performance and reporting, where managerial discretion over loan classification, provisioning, and valuation directly influences reported earnings and the credibility of financial statements.

Within Kenya's listed commercial banks, this relationship is particularly significant due to the dominance of loans and advances in bank asset structures. Such reliance on credit-based assets increases vulnerability to earnings smoothing through delayed recognition of non-performing loans or discretionary provisioning. Consequently, evaluating asset management using indicators such as abnormal asset growth and non-performing asset ratios provides not only a measure of operational efficiency but also an important diagnostic tool for assessing financial reporting quality. Ultimately, disciplined asset management supported by robust governance frameworks, regulatory compliance, and transparent disclosure practices strengthens financial reporting credibility and mitigates the risk of earnings manipulation.

### 2.5.3 Debt Management and Financial Reporting Quality

Debt management and financial reporting quality are closely interrelated because the manner in which banks measure, classify, and provision for credit exposures directly influences reported liabilities, profitability, and the credibility of financial information available to investors, lenders, and regulators. In banking institutions, debt management practices, including loan monitoring, provisioning for credit losses, and liability structuring, shape both financial stability and the transparency of financial reports. Effective debt management requires prudent recognition of loan losses, clear disclosure of covenant obligations, and consistent classification of liabilities. These practices reduce information asymmetry between banks and stakeholders and contribute to lower borrowing costs. Conversely, opportunistic practices such as discretionary loan-loss provisioning, reclassification of liabilities, or manipulation of covenant compliance may distort reported earnings and undermine the reliability of financial statements.

Empirical studies provide mixed insights into the relationship between debt management and financial reporting outcomes. Amrah and Hashim (2020) demonstrate that higher financial reporting quality is associated with a lower cost of debt, suggesting that lenders reward transparent and credible financial disclosures with favorable borrowing terms. Their findings emphasize the economic benefits of high-quality reporting in debt markets. However, the study's regional focus and cross-sectional research design limit the ability to establish causal relationships and restrict the generalizability of the findings to other banking environments.

Similarly, Etoromat (2022) found that debt management literacy significantly influences the financial performance of savings and credit cooperative organizations (SACCOs). The study highlights the importance of managerial competence and debt governance in improving financial outcomes. While these findings provide useful insights into the role of debt management capabilities, the reliance on self-reported data and the focus on non-bank financial institutions limit their direct applicability to commercial banks, where regulatory oversight and financial reporting requirements are significantly more complex.

Further evidence is provided by Valaskova and Gajdosikova (2021), who identified a non-linear relationship between leverage and firm performance. Their findings suggest that optimal levels of indebtedness can enhance profitability by enabling firms to leverage financial resources efficiently. However, excessive leverage increases financial distress risks and may create pressure on management to manipulate financial reports in order to maintain investor confidence and comply with debt covenants. This highlights the potential tension between leverage optimization and financial reporting transparency.

Within the Kenyan banking context, Owich and Mutswenje (2021) examined debt management practices such as credit assessment procedures, loan monitoring systems, and collateral management. Their study found that these operational debt management practices significantly influence loan performance and financial sustainability. However, the research focused primarily on Tier II and Tier III banks and relied on survey-based methods, leaving unanswered questions regarding disclosure practices and accounting decisions among listed commercial banks where regulatory scrutiny and market discipline are more pronounced.

Collectively, the literature suggests three key mechanisms through which debt management may influence financial reporting quality in banking institutions. First, provisioning discretion allows managers to adjust loan-loss provisions to smooth earnings or meet debt covenant requirements. Second, liability classification and covenant management enable managers to restructure or reclassify obligations in ways that obscure the true leverage position and financial risk of the institution. Third, market discipline mechanisms imply that transparent debt reporting improves investor confidence and reduces borrowing costs, thereby incentivizing higher reporting quality. Despite these insights, existing empirical studies are constrained by cross-sectional research designs, limited samples, and heavy reliance on self-reported data, with relatively little attention given to the moderating role of corporate governance in constraining opportunistic financial reporting behavior.

This study addresses these limitations by focusing specifically on listed commercial banks in Kenya, where debt disclosure requirements, regulatory oversight, and market discipline interact to shape financial reporting practices. The study adopts a longitudinal and cross-sectional analytical framework to improve causal inference and employs objective accounting proxies such as loan-loss provisions to gross loans, leverage ratios, and covenant compliance indicators to measure debt management practices. Additionally, corporate governance is incorporated as a moderating variable to assess whether stronger governance structures constrain opportunistic provisioning and liability manipulation. By examining these relationships, the study seeks to determine whether debt management practices enhance genuine financial performance or facilitate earnings management that undermines financial reporting quality.

**2.5.4 Expense Management and Financial Reporting Quality**

Expense management and financial reporting quality are closely interconnected through managerial discretion in the recognition, timing, and classification of organizational costs. In commercial banks, operating and non-operating expenses, including administrative costs, staff expenses, and loan-loss provisions, constitute major determinants of reported profitability and financial stability. Effective expense management requires disciplined cost control, accurate cost allocation, and transparent recognition of expense provisions. These practices ensure that financial statements faithfully represent the bank's economic performance and allow stakeholders to assess operational efficiency and risk exposure. However, managerial discretion in expense recognition may also create opportunities for earnings management. Managers may defer, accelerate, or reclassify expenses in order to smooth income, meet performance targets, or comply with regulatory requirements. Such practices undermine the reliability, comparability, and transparency of financial reports, thereby affecting stakeholder confidence and market valuation.

Empirical studies provide important insights into the relationship between expense management and financial performance, although their implications for financial reporting quality remain less extensively examined. Djurakulovna (2025) analyzed the income and expense dynamics of a commercial bank using financial ratio analysis to assess overall financial performance. The findings indicated that cost efficiency significantly influences profitability and financial stability. Nevertheless, the study was constrained by limited methodological transparency and the absence of peer benchmarking, which restricted the ability to compare performance across institutions. In contrast, the present study addresses this limitation by incorporating sector-wide benchmarking across listed commercial banks and employing a comprehensive analytical framework that captures both cross-sectional and temporal variations in expense management practices.

Similarly, Safitri and Machmuddah (2025) investigated the relationship between operating expenses, capital adequacy, and profitability among Indonesian banks. Their findings revealed that operating expenses exert a significant negative influence on bank performance, while capital adequacy did not demonstrate a statistically significant effect. These results emphasize the importance of cost control as a key determinant of bank profitability. However, the study relied on cross-sectional data, which limits its capacity to capture the dynamic nature of expense management practices over time. The present study extends this line of inquiry by employing longitudinal data to model the temporal effects of expense management on financial reporting outcomes, thereby improving causal inference.

Further insights are provided by Erasmus (2021), who examined cost management techniques such as activity-based costing (ABC), target costing, and standard costing within Nigerian banks. The study found that ABC and standard costing significantly improved profitability and cost transparency, while target costing demonstrated limited effectiveness. These findings suggest that structured cost management systems contribute to improved financial performance and reporting accuracy. Nonetheless, the study's mixed-method design relied heavily on self-reported perceptions rather than audited financial disclosures, which may introduce response bias. By contrast, the present study utilizes audited financial statement data to capture actual expense adjustments and their accrual implications, thereby strengthening measurement reliability and construct validity.

Additional evidence is provided by Ghanbari, Abbasi, Didekhani, and Ashrafi (2022), who examined the role of strategic cost management in enhancing operational efficiency and financial performance within Iranian firms. Their structural equation modeling results demonstrated that disciplined cost control significantly strengthens the relationship between operational efficiency and financial outcomes. However, the study's focus on manufacturing firms limits the direct applicability of its findings to banking institutions, where expense recognition is strongly influenced by provisioning requirements and regulatory reporting frameworks. This sectoral difference highlights the need for banking-specific research examining how expense management practices influence financial reporting quality.

Synthesizing across these studies, it is evident that expense management affects financial reporting quality primarily through discretionary cost adjustments, income smoothing mechanisms, and transparency in cost allocation. Excessive discretion in expense provisions, particularly in areas such as loan-loss provisioning and administrative cost recognition, may obscure the true cost structure of financial institutions and reduce the comparability of financial statements. Conversely, disciplined expense management supported by transparent provisioning policies and accurate cost allocation enhances financial reporting credibility and strengthens investor confidence.

Within the context of Kenya's listed commercial banks, expense management plays a particularly significant role in shaping financial reporting outcomes. The banking sector operates within a strict regulatory environment governed by disclosure requirements from the Central Bank of Kenya, which emphasize transparency in expense recognition and provisioning practices. Consequently, this study adopts the Operating Expense Provisions to Total Income Ratio as a key empirical indicator of expense management. This measure captures both cost efficiency and managerial discretion in expense recognition. By integrating this indicator with the Modified Jones Model as a proxy for financial reporting quality, the study seeks to empirically examine how expense-related earnings management influences the transparency, reliability, and value relevance of financial reports among listed commercial banks in Kenya.

**2.4.5 Corporate Governance and Financial Reporting Quality**

Corporate governance and financial reporting quality (FRQ) are causally interlinked: governance structures shape managerial incentives and monitoring capacity, which in turn constrain or enable earnings management and thus determine the credibility, transparency, and comparability of financial disclosures. Empirical evidence confirms the link but is context-sensitive, governance attributes that strengthen FRQ in one institutional setting may be neutral or counterproductive in another. This heterogeneity underscores the need for country- and sector-specific analysis, especially for regulated, deposit-taking institutions such as banks.

Hasan, Aly, and Hussainey (2022) provide cross-country evidence that governance effects vary: board size reduced FRQ, foreign ownership improved it, and board independence mattered in Pakistan but not uniformly across the UK sample. Their results illustrate two points, first, governance attributes exert differential influences on accrual-based measures of reporting quality; second, institutional context conditions these effects. Methodologically, reliance on accrual models offers internal validity for earnings manipulation detection but limits the scope for market-based validation.

Hsu and Yang (2022) show that systemic shocks (COVID-19) lower FRQ via increased real-activity manipulation; larger boards mitigated this decline whereas board independence and CEO duality did not. Their findings signal that governance effectiveness can be dynamic—resilience under stress may depend on specific board capacities rather than formal independence alone. This highlights the value of testing governance functionality (what boards do) rather than only form (board composition).

Gardi, Aga, and Abdullah (2023) document that IFRS adoption mediates the governance, FRQ relationship in Iraqi private banks: governance practices enhance FRQ more effectively when IFRS implementation is credible. This suggests an interaction effect: governance mechanisms and accounting regime quality are complementary strong governance without robust reporting standards or enforcement yields limited FRQ gains. Kaawaase et al. (2021) emphasize internal controls and board expertise: in Ugandan financial institutions, board expertise and internal audit quality significantly improve FRQ, while formal independence did not. Their results point to oversight capability and monitoring effectiveness as the operative channels through which governance enhances reporting quality.

Collectively the literature yields three consistent mechanisms: (1) monitoring and oversight, boards and audit committees reduce discretionary reporting; (2) incentive alignment, ownership structure and remuneration design affect managerial reporting choices; (3) institutional complementarity, accounting standards and enforcement interact with governance to shape FRQ. Empirical differences stem from sample composition, measurement (accrual vs. market-based), crisis conditions, and governance operationalization.

Key gaps remain. Many studies use cross-sectional designs, self-reported governance proxies, or single-country samples, limiting causal inference and generalizability to listed banks under strong prudential regimes. There is sparse evidence that jointly tests governance as a moderator of the earnings-management, FRQ path using both accrual-based and market-based FRQ measures in emerging-market banking contexts.

This study addresses those gaps by focusing on listed commercial banks in Kenya, using objective governance metrics aggregated into a Corporate Governance Index, combining Modified Jones discretionary accruals with value-relevance ($R^2$ of PRICE on EPS) measures of FRQ, and employing longitudinal panel methods to test governance as a moderator under varying market conditions. The approach isolates whether governance reduces opportunistic reporting and enhances both accounting-based and market-based reporting quality in a regulated banking environment.

## 3. Research Methodology

### 3.1 Research Philosophy

The study adopted a positivist research philosophy, which emphasizes objective observation, quantification, and empirical validation of phenomena. Positivism asserts that knowledge is derived from observable and measurable facts rather than subjective interpretation (Bhattacharyya, 2009). In line with this perspective, the study focused on identifying and testing relationships between quantifiable variables, specifically, earnings management practices and financial reporting quality in listed commercial banks in Kenya.

### 3.2 Research Design

The study adopted an ex post facto, panel-based quantitative research design under a descriptive–correlational framework to examine the relationship between earnings management and financial reporting quality among listed commercial banks in Kenya over a ten-year period. This design is methodologically appropriate because it leverages historical, audited financial data to analyze behavioral and performance patterns without manipulating the variables under study. Earnings management and financial reporting quality are inherently retrospective phenomena, best captured through empirical evaluation of past financial records rather than experimental control.

### 3.3 Target Population

The study targeted all eleven (10) listed commercial banks in Kenya as identified on the Nairobi Securities Exchange (NSE) during the study period. As defined by Mugenda and Mugenda (2003), a population comprises all entities sharing common characteristics relevant to the study. These banks are selected because they consistently publish audited financial statements in compliance with IFRS and CBK Prudential Guidelines, ensuring uniformity and data reliability. Their regulatory consistency and public accountability make them ideal for analyzing the relationship between earnings management and financial reporting quality. Focusing on the entire population eliminates sampling error, strengthens generalizability, and provides comprehensive sectoral insights.

### 3.4. Data Processing, Analysis, and Presentation

Data processing began with editing, cleaning, and validation using Microsoft Excel to ensure completeness, consistency, and accuracy before analysis. Any missing or inconsistent entries were systematically addressed through cross-verification with original financial reports and regulatory filings. The cleaned dataset was then be exported to STATA for statistical analysis. The study employed both descriptive and inferential statistical techniques to analyze the panel data. Descriptive statistics (mean, minimum, maximum, and standard deviation) summarized the distributional characteristics of the study variables, providing insights into trends, variability, and data dispersion across banks and over time.

Inferential statistics was used to examine relationships, test hypotheses, and draw conclusions. Specifically, panel linear regression models were applied to estimate the effect of earnings management on financial reporting quality. Panel analysis was suitable for this study because it combined cross-sectional and time-series dimensions, which enables the researcher to capture the dynamic behavior of commercial banks and to observe changes in financial reporting patterns across multiple years. This design improved the robustness of the analysis by controlling for unobserved heterogeneity, such as managerial culture, risk appetite, governance practices, or internal reporting policies, which may differ across banks but remain relatively constant over time. A correlation analysis established the strength and direction of relationships among key variables. The Hausman test indicated that random effect model was most appropriate for the study. Findings were presented through tables, figures, and graphs to enhance clarity, interpretation, and visual comprehension. This analytical framework allowed for a robust examination of both direct and moderated relationships, aligning with the study's positivist stance by ensuring statistical objectivity, replicability, and empirical precision

The analytical models were specified as follows:

Model 3.1 (Baseline model – without moderation):

$$FRQ_{it} = \beta_0 + \beta_1 RM_{it} + \beta_2 AM_{it} + \beta_3 DM_{it} + \beta_4 ExM_{it} + \varepsilon_{it} \ldots \quad (3.1)$$

Model 3.2 (Moderated model – with corporate governance):

$$FRQ_{it} = \beta_0 + \beta_1 CG_{it} + \beta_2 EM_{it} + \beta_3 EM_{it}.CG_{it} + \varepsilon_{it} \ldots\ldots\ldots \quad (3.2)$$

Where:
FRQ – Represents financial reporting quality,
$\beta_0$ – Constant,
$\beta_1$, $\beta_2$, $\beta_3$, $\beta_4$, – Regression coefficients,
EM-Earning Management,
RM – Revenue Management,
AM – Asset Management,
DM – Debt Management,
ExM – Expense Management,
CG – Corporate Governance,
i – Denotes the observations (Commercial Banks),
t – Represents the time dimensions from 2004 to 2024,
$\varepsilon_{it}$ – The error term.

## 4. Data Analysis Presentation and Interpretation

### 4.1 Descriptive Statistics

Descriptive statistics were used to summarize the key characteristics of the study variables. The analysis presents the mean, standard deviation, minimum, and maximum values to provide an overview of the distribution and variability of financial reporting quality, revenue management, asset management, debt management, expenses management, and corporate governance. The findings are presented in Table 4.1 below.

**Table 4.1:** Descriptive Statistics

| Variable | N | Mean | SD | Min | Max |
|---|---|---|---|---|---|
| FRQ | 180 | 0.5332 | 0.2062 | 0.0149 | 0.9735 |
| RM | 180 | 0.4621 | 0.2059 | 0.0132 | 0.9478 |
| AM | 180 | 0.5437 | 0.1992 | 0.0835 | 0.9732 |
| DM | 180 | 0.4605 | 0.2188 | 0.0117 | 0.9492 |
| ExM | 180 | 0.5687 | 0.2086 | 0.0912 | 0.9912 |
| CG | 180 | 0.4937 | 0.1865 | 0.0117 | 0.9134 |

**Source:** Study Data (2026).

Table 4.1 presents the descriptive statistics of the study variables based on 180 observations. These observations were collected from 10 commercial banks listed on the

Nairobi Securities Exchange (NSE). The descriptive statistics provide insights into the central tendency, spread, and variability of the key study variables, including financial reporting quality (FRQ), earnings management components, revenue management (RM), asset management (AM), debt management (DM), and expense management (ExM), as well as corporate governance (CG).

During data preparation, it was observed that one bank exhibited extreme values across several variables, which could disproportionately influence the results and potentially bias the analysis. This bank was therefore excluded from the study, resulting in 180 usable observations from the remaining nine banks. Removing this outlier ensured the reliability and validity of the descriptive statistics and subsequent inferential analyses.

### 4.1.1 Financial Reporting Quality

Financial reporting quality (FRQ), measured using the Modified Jones Model, recorded a mean of 0.5332 with a standard deviation of 0.2062. This indicates that, on average, the financial reporting quality of the sampled commercial banks in Kenya is moderate, reflecting a balance between generally accurate reporting and instances of earnings management. The Modified Jones Model is widely recognized for its ability to detect discretionary accruals, which are accounting adjustments made at management's discretion to influence reported earnings. The use of this model in the study provides a reliable measure of the quality of reported financial information, allowing for the identification of potential manipulations that could compromise transparency and reliability.

The mean value of 0.5332 suggests that most banks report earnings that are reasonably reliable; however, it also indicates that some level of earnings management is prevalent. This moderate mean aligns with findings from prior studies that highlight the presence of earnings management in the banking sector as a tool for smoothing profits, meeting market expectations, or complying with regulatory requirements. In practical terms, the moderate quality implies that financial statements can generally be relied upon for decision-making by stakeholders, but investors, regulators, and other users should remain cautious, as discretionary accruals can still distort the true financial performance of the institutions.

The standard deviation of 0.2062 indicates that there is noticeable variation in financial reporting quality among the sampled banks. This suggests that while some banks demonstrate high-quality reporting with minimal discretionary adjustments, others engage more heavily in earnings management practices. The observed variation may be attributed to multiple factors, including differences in internal control systems, accounting policies, managerial incentives, risk exposure, and adherence to statutory and regulatory requirements. Banks with robust internal controls, independent audit committees, and transparent reporting cultures are likely to maintain higher reporting quality, whereas those with weaker oversight mechanisms may be more susceptible to earnings manipulation.

The minimum value of 0.0149 and the maximum value of 0.9735 further underscore the heterogeneity within the sample. A few banks exhibit near-perfect financial reporting quality, indicating rigorous adherence to accounting standards and minimal discretionary accruals. Conversely, some banks demonstrate very low reporting quality, suggesting significant earnings management, which could be motivated by the desire to achieve certain financial targets, enhance market perception, or manage regulatory capital requirements. This disparity highlights the uneven adoption of best practices in financial reporting within Kenya's banking sector and suggests the need for targeted regulatory interventions to ensure uniform standards of transparency and accountability.

Moreover, the variation in financial reporting quality has broader implications for stakeholders. For investors, the presence of earnings management increases the difficulty of accurately assessing the bank's financial health and performance, which can affect investment decisions. For regulators, the findings highlight areas where stricter monitoring and enforcement may be necessary to curb manipulative practices. For management, it indicates the importance of implementing stronger internal controls and governance frameworks to enhance reporting quality, reduce the likelihood of discretionary manipulations, and strengthen stakeholder confidence.

Overall, the results demonstrate that while financial reporting quality in the sampled commercial banks is generally moderate, there exists substantial variation, with some banks achieving high-quality reporting and others showing significant manipulation through discretionary accruals. The findings emphasize the importance of effective corporate governance, strong regulatory oversight, and ethical managerial practices to mitigate earnings management and enhance the reliability and transparency of financial reporting within the Kenyan banking sector.

### 4.2.2 Revenue Management

Revenue management, measured through the Revenue Growth Smoothing Index, recorded a mean of 0.4621 with a standard deviation of 0.2059. The Revenue Growth Smoothing Index is designed to capture the extent to which banks manipulate the timing and recognition of revenue to create a consistent or "smoothed" growth pattern over time. Such practices may obscure the bank's true financial performance by artificially stabilizing revenue streams, which can mislead investors, regulators, and other stakeholders regarding the bank's operational efficiency and profitability.

The mean value of 0.4621 indicates that, on average, the sampled commercial banks engage in moderate levels of revenue smoothing. This suggests that revenue management is neither negligible nor extreme across the sector, but is a commonly used tool by management to influence reported earnings. The moderate standard deviation of 0.2059 further implies variability among banks, meaning that while some banks maintain minimal intervention in revenue recognition, others actively employ revenue smoothing techniques. The minimum value of 0.0132 and maximum of 0.9478 highlight the wide range of practices, reflecting heterogeneity in managerial behavior, internal controls, and institutional culture across the banks.

The presence of moderate revenue management can be attributed to several factors. First, managerial incentives play a significant role, as executives may seek to meet earnings forecasts, maintain stock market credibility, or achieve performance-based bonuses. Second, banks may use revenue smoothing to protect against volatility in income that arises from external economic pressures, such as fluctuations in interest rates, loan demand, or regulatory changes. By stabilizing reported revenue, management can convey an image of consistent growth, which may enhance investor confidence and reduce the perceived risk of the institution.

Additionally, the variability in revenue management across banks may reflect differences in strategic priorities and risk tolerance. Some banks with stronger governance frameworks and rigorous internal monitoring may limit the extent of revenue smoothing, adhering more closely to conservative accounting practices. Conversely, banks with weaker oversight or higher competitive pressures may resort to more aggressive revenue management to meet expectations. The findings suggest that revenue management practices are context-dependent and influenced by both internal organizational factors and external market pressures.

Overall, these results indicate that while revenue management is moderately practiced across the sampled commercial banks, there is substantial variation among institutions. This variability highlights the need for robust corporate governance and regulatory oversight to ensure that revenue recognition practices do not compromise the reliability and transparency of financial reporting. Proper monitoring mechanisms, including independent audit committees, regulatory inspections, and internal control systems, can help mitigate excessive revenue smoothing and promote financial statement integrity.

### 4.1.3 Asset Management

Asset management, measured through Abnormal Asset Growth, recorded a mean of 0.5437 with a standard deviation of 0.1992. Abnormal asset growth captures instances where banks adjust the level of assets in ways that may influence reported earnings beyond normal growth expectations. Such adjustments can include accelerating asset recognition, revaluing existing assets, or timing asset acquisitions and disposals to improve financial results. The mean of 0.5437 indicates that, on average, banks engage moderately in asset management to influence reported earnings, suggesting that this practice is a common tool for smoothing or enhancing financial performance.

The standard deviation of 0.1992 demonstrates noticeable variation among banks, implying that while some banks employ minimal asset adjustments, others utilize them more aggressively. The minimum and maximum values of 0.0835 and 0.9732 further underscore the heterogeneity in asset management practices across the sampled banks. This variation may reflect differences in the composition and size of asset portfolios, management strategies, and the effectiveness of internal controls. Banks with more complex or larger asset bases may have greater opportunities and incentives to manipulate asset growth to influence financial reporting outcomes.

Moderate asset management can affect financial reporting quality, as discretionary adjustments to assets may inflate earnings or distort financial ratios, potentially misleading stakeholders about the bank's true financial position. High-quality financial reporting requires that asset growth aligns with genuine operational activities and economic reality. Consequently, variations in asset management across banks may partially explain differences in the reported financial reporting quality observed in the sample. The findings suggest that regulatory oversight, auditing standards, and effective internal governance are critical to mitigating excessive asset manipulation and ensuring the reliability of financial statements.

### 4.1.4 Debt Management

Debt management, measured using Loan Loss Provisions to Gross Total Loans, had a mean of 0.4605 and a standard deviation of 0.2188. Loan loss provisions serve as a mechanism for banks to adjust earnings by controlling the recognition of potential loan defaults. A mean of 0.4605 indicates that, on average, banks moderately use debt management practices to influence reported profits. The standard deviation suggests considerable variability across banks, while the minimum and maximum values of 0.0117 and 0.9492 reflect the wide range of practices—from minimal adjustments to aggressive provisioning.

Debt management affects financial reporting quality because discretionary adjustments to loan loss provisions directly impact net income and financial ratios without necessarily affecting cash flows. Banks with more aggressive provisioning may seek to smooth earnings, manage regulatory capital, or respond to market pressures. Conversely, conservative provisioning may reflect stronger governance and compliance with regulatory standards. The variation in debt management practices highlights the role of internal controls and managerial discretion in influencing financial reporting outcomes.

Moderate engagement in debt management suggests that while the practice is commonly employed, its extent is balanced by internal and external oversight mechanisms. However, excessive or poorly disclosed adjustments could compromise the transparency and reliability of financial reports. These findings emphasize the importance of audit oversight, effective risk management, and corporate governance in mitigating the potentially negative effects of debt management on financial reporting quality.

### 4.1.5 Expense Management

Expense management, measured through Operating Expense Provisions to Total Income, recorded the highest mean among the earnings management components at 0.5687, with a standard deviation of 0.2086. Expense management reflects the extent to which banks adjust operating expenses, either accelerating or deferring them, to influence reported earnings. The higher mean indicates that, on average, expense management is the most frequently employed mechanism to manage earnings among the sampled banks.

The standard deviation of 0.2086 and the range of 0.0912 to 0.9912 demonstrate substantial variation in expense management practices, suggesting that some banks manipulate expenses minimally, while others employ it extensively to smooth profits or meet financial targets. Expense adjustments are relatively less visible to external stakeholders compared to revenue or asset manipulations, making them a convenient tool for management to influence reported earnings without attracting immediate scrutiny.

While moderate expense management can be consistent with legitimate accrual-based accounting, excessive use may reduce financial reporting quality by distorting profit levels and misrepresenting operational efficiency. The findings highlight the importance of robust governance, disclosure standards, and auditing practices in monitoring expense management activities. By ensuring that expense adjustments reflect genuine economic events rather than opportunistic earnings manipulation, banks can maintain transparency and investor confidence.

**4.1.6 Corporate Governance**

Corporate governance, measured using a Corporate Governance Index, had a mean of 0.4937 and a standard deviation of 0.1865. The index captures governance mechanisms such as board composition, independence of audit committees, internal controls, transparency in reporting, and compliance with statutory and regulatory standards. The moderate mean indicates that governance practices among the sampled banks are neither weak nor exceptionally strong, but there is considerable room for improvement.

The standard deviation and the range of 0.0117 to 0.9134 highlight significant variability in governance quality across banks. Some banks demonstrate robust governance frameworks that are likely to limit excessive earnings management, while others with weaker governance structures may be more susceptible to manipulative practices that reduce financial reporting quality. Corporate governance plays a critical moderating role in the relationship between earnings management and financial reporting quality, as effective oversight, accountability, and ethical leadership can mitigate discretionary adjustments to revenue, assets, debt, and expenses.

The variability observed suggests that differences in governance structures may help explain why some banks exhibit higher financial reporting quality than others, despite similar levels of earnings management. Strong governance can reinforce transparency, ensure compliance with accounting standards, and enhance stakeholder confidence, whereas weak governance increases the risk of aggressive earnings manipulation and reduced reliability of financial statements.

## 4.2 Inferential Statistics

### 4.2.1 Correlational Analysis

Correlation analysis was conducted to examine the strength and direction of the linear relationships between the study variables. This analysis provides insights into how earnings management components, revenue management, asset management, debt management, and expense management, as well as corporate governance, relate to financial reporting quality in listed commercial banks in Kenya. The Pearson correlation coefficient was used to quantify these relationships, with values ranging from -1 to +1. A positive correlation indicates that an increase in one variable is associated with an increase in the other, while a negative correlation indicates an inverse relationship. Significance levels were assessed to determine whether the observed correlations are statistically meaningful, guiding interpretation for subsequent regression analysis. The correlation analysis also helps identify potential multicollinearity issues among independent variables and provides a preliminary understanding of the variables' interactions before testing the study hypotheses. The results of the correlation analysis are presented in Table 4.6.

**Table 4.2:** Correlation Analysis

| Variable | FRQ | RM | AM | DM | ExM | CG |
|---|---|---|---|---|---|---|
| FRQ | 1.0000 | | | | | |
| RM | -0.4145*<br>(0.0000) | 1.0000 | | | | |
| AM | -0.1399*<br>(0.0110) | -0.1897*<br>(0.1108) | 1.0000 | | | |
| DM | -0.3912*<br>(0.0000) | 0.1621<br>(0.1297) | -0.0131<br>(0.8613) | 1.0000 | | |
| ExM | -0.1649*<br>(0.0270) | 0.0248<br>(0.7411) | -0.1110<br>(0.1379) | 0.0942<br>(0.2086) | 1.0000 | |
| CG | 0.4705*<br>(0.0000) | 0.3304<br>(0.0811) | -0.1117<br>(0.1355) | 0.4403<br>(0.1420) | 0.0629<br>(0.4019) | 1.0000 |

**Source:** Study Data (2026).

Table 4.6 presents the correlation coefficients between financial reporting quality (FRQ), the components of earnings management, revenue management (RM), asset management (AM), debt management (DM), and expense management (ExM), and corporate governance (CG) for the sampled commercial banks. The analysis provided an initial understanding of the strength and direction of relationships among these variables prior to conducting regression analysis.

The results show that financial reporting quality is negatively associated with all components of earnings management, although the magnitude of these relationships varies. Revenue management exhibits a negative and statistically significant correlation with FRQ (-0.4145, p = 0.0000), indicating that banks that engage in revenue smoothing tend to report lower quality financial statements. Asset management also shows a significant negative correlation with FRQ (-0.1399, p = 0.0110), suggesting that abnormal asset growth slightly diminishes reporting quality. Debt management is negatively correlated with FRQ (-0.3912, p = 0.0000), highlighting that discretionary adjustments in loan loss provisions are associated with reduced transparency and reliability in financial reporting. Expense management has a negative correlation (-0.1649, p = 0.0270), indicating a minor yet significant effect on FRQ. Collectively, these findings confirm the expectation that higher levels of earnings management are linked to lower financial reporting quality.

Corporate governance shows a positive and significant correlation with FRQ (0.4705, p = 0.0000), implying that banks with better governance mechanisms tend to have higher financial reporting quality. This supports the notion that effective governance, including independent boards, audit committees, and internal controls, can reduce discretionary earnings management and enhance the reliability of financial statements.

The correlations among independent variables are generally weak and statistically non-significant, indicating minimal multicollinearity. For example, the highest correlation among independent variables is 0.4403 between debt management and corporate governance, which is not statistically significant (p = 0.1420). This suggests that each variable provides unique explanatory power in predicting FRQ and supports the validity of including all variables in regression analysis.

Overall, the correlation analysis provides preliminary evidence that revenue and debt management have the most substantial negative impact on financial reporting quality, while asset and expense management have smaller effects. Corporate governance, on the other hand, plays a protective role, mitigating the negative effects of earnings management and enhancing financial reporting quality.

### 4.2.2 Random Effect Model Results Without Moderation Effect

The Random Effects model is employed in this study to examine the impact of earnings management components, revenue management, asset management, debt management, and expense management, alongside corporate governance on financial reporting quality in listed commercial banks in Kenya. Panel data techniques are particularly useful in this context because they account for variations both within and between banks over the study period. Unlike the Fixed Effects model, which only captures within-bank changes, the RE model assumes that unobserved bank-specific effects are uncorrelated with the explanatory variables, allowing for more efficient estimation.

The choice of the Random Effects model in this study was guided by the Hausman specification test, which indicated that the differences between the Fixed and Random Effects coefficients are not systematic. This confirms that the RE model is consistent and efficient for estimating the relationships of interest. By incorporating both cross-sectional and time-series variations, the RE model provides a comprehensive understanding of how earnings management practices and corporate governance influence financial reporting quality across the sampled banks. The random effect model results are shown in Table 4.8.

**Table 4.3:** Random Effect Model

| Variable | Coef. | Std. Err. | T | P>/z/ |
|---|---|---|---|---|
| RM | -.4089 | .0566 | -7.22 | 0.001 |
| AM | -.3719 | .0412 | -9.99 | 0.000 |
| DM | -.2857 | .0611 | -4.68 | 0.000 |
| ExM | -.2140 | .0359 | -5.96 | 0.000 |
| Con. | .7638 | .0086 | -8.88 | 0.002 |
| | Within<br>Between<br>Overall | = 0.7310<br>= 0.7484<br>= 0.7314 | Wald chi2(3)<br>Prob>chi2 | = 473.38<br>=0.0000 |

**Source:** Stata (2026).

### 4.2 Overview of Findings

Regression analysis was employed to test the study's hypotheses because the diagnostic tests, including multicollinearity, heteroscedasticity, normality, and stationarity, indicated that the assumptions of linear regression had not been violated. The Hausman specification test further confirmed that the Random Effects (RE) model was the most appropriate for analyzing the panel data, as the differences between Fixed and Random Effects coefficients were not systematic. The RE model was therefore used to assess how earnings management practices, revenue management (RM), asset management (AM), debt management (DM), and expense management (ExM), affect financial reporting quality (FRQ) in listed commercial banks in Kenya, while accounting for variations across banks and over time. The overall fit of the model is strong, with an $R^2$ of 0.7314, indicating that approximately 73% of the variation in financial reporting quality is explained by the independent variables included in the model. The model is statistically significant, as indicated by the Wald chi-square statistic of 473.38 ($p < 0.001$), confirming that the combined effect of the explanatory variables on FRQ is meaningful. The results of the Random Effects regression are presented in Table 4.8 and summarized in the regression equation (Equation 4.1):

$$FRQ_{it}=0.7638-0.4089RM_{it}-0.3719AM_{it}-0.2857DM_{it}-0.2140ExM_{it}$$

As per the regression results, the constant term of 0.7638 indicates that, in the absence of earnings management practices, the financial reporting quality of the sampled banks would be 0.7638. This represents the baseline level of reporting quality when revenue, asset, debt, and expense management are not applied.

### 4.2.2 Revenue Management and Financial Reporting Quality

The results in Table 4.8 demonstrate that revenue management is a significant determinant of financial reporting quality in listed commercial banks. The Random Effects regression analysis shows a coefficient of -0.4089 with a p-value of 0.001, which is below the 0.05 significance level, indicating a statistically significant negative relationship. This implies that an increase in revenue management practices, such as revenue smoothing or manipulation, reduces the quality of financial reporting. These results imply that an increase in revenue management practices reduces financial reporting quality by 40.89%. These findings confirm that revenue management practices play a critical role in influencing financial reporting quality and that banks that engage in aggressive revenue manipulation tend to compromise the transparency, reliability, and credibility of their financial statements.

#### 4.4.3 Asset Management and Financial Reporting Quality

The results in Table 4.8 indicate that asset management is a significant determinant of financial reporting quality among listed commercial banks. The Random Effects regression results show a negative coefficient of -0.3719 with a p-value of 0.000, which is well below the 0.05 level of significance, confirming a statistically significant negative relationship. This finding implies that an increase in asset management practices, measured through abnormal asset growth, leads to a decline in financial reporting quality. Specifically, a one-unit increase in abnormal asset growth is associated with an approximate 37.19% reduction in financial reporting quality. This suggests that discretionary adjustments in asset recognition, valuation, or growth are likely to distort the true financial position of banks, thereby undermining the accuracy, transparency, and reliability of reported financial information. The results underscore that aggressive asset management practices compromise the integrity of financial reports and highlight the importance of stringent asset controls and effective regulatory oversight in enhancing financial reporting quality within the banking sector.

#### 4.4.4 Debt Management and Financial Reporting Quality

The results in Table 4.8 show that debt management is a significant determinant of financial reporting quality among listed commercial banks. The Random Effects regression analysis indicates a negative coefficient of -0.2857 with a p-value of 0.000, which is below the 0.05 level of significance. This confirms a statistically significant negative relationship between debt management practices and financial reporting quality. The findings imply that a one-unit increase in debt management, measured through loan loss provisions to gross total loans, leads to an approximate 28.57% decline in financial reporting quality. This suggests that discretionary adjustments in loan loss provisions, which are often used by banks to smooth earnings or manage perceived credit risk, may distort the accuracy and reliability of financial statements. Consequently, excessive or manipulative debt management practices can compromise transparency, reduce the credibility of reported earnings, and weaken stakeholders' confidence in the financial reports. The results, therefore, highlight the need for stronger credit risk assessment procedures, prudent provisioning policies, and effective regulatory supervision to enhance the quality of financial reporting within the banking sector.

#### 4.4.5 Expense Management and Financing Reporting Quality

The results in Table 4.8 indicate that expense management is a significant determinant of financial reporting quality in listed commercial banks. The Random Effects regression analysis shows a negative coefficient of -0.2140 with a p-value of 0.000, which is below the 0.05 level of significance. This demonstrates a statistically significant negative relationship between expense management practices and financial reporting quality. The findings imply that a one-unit increase in expense management, measured through operating expense provisions to total income, results in an approximate 21.40% decline in financial reporting quality. This suggests that discretionary adjustments in operating expenses, such as timing of expense recognition or manipulation of provisions, may be used by management to smooth earnings or achieve targeted financial outcomes. Such practices can distort the true financial position and performance of the banks. Consequently, aggressive or opportunistic expense management practices may reduce the transparency, reliability, and credibility of financial statements. These findings highlight the importance of strong internal controls, effective expense monitoring systems, and robust corporate governance mechanisms to ensure that expense recognition practices are aligned with accounting standards and reflect the true economic performance of the banks.

### 4.5 Discussion of Findings

#### 4.5.1 Revenue Management and Financial Reporting Quality

The empirical results of this study reveal that revenue management has a negative and statistically significant effect on financial reporting quality among listed commercial banks in Kenya. The random effects regression produced a coefficient of -0.4089 ($p < 0.001$), indicating that increased revenue management practices significantly reduce the quality, transparency, and reliability of financial reports. These findings are consistent with the broader literature, which suggests that while revenue management may be used strategically to stabilize earnings, excessive managerial discretion often leads to opportunistic behavior that undermines reporting credibility.

The findings align closely with the observations of Nancy-Seelye (2022), who noted that revenue management in U.S. banks during the COVID-19 period involved adaptive pricing and product-mix adjustments to sustain performance. While these strategies improved short-term financial outcomes, the study also highlighted that increased managerial discretion during periods of uncertainty creates opportunities for earnings manipulation. This supports the present study's results, which show that greater involvement in revenue smoothing and discretionary revenue recognition is associated with reduced financial reporting quality.

Similarly, the work of Natesan et al. (2023) demonstrated that pricing strategies and interest rate decisions in Indian banks directly influence both profitability and perceived financial strength. Their findings suggest that revenue management decisions are not purely operational but also shape reported performance. This supports the current study's conclusion that discretionary revenue practices, when not governed by strict controls, can distort financial outcomes and reduce reporting quality.

Studies outside the banking sector, such as Murimi et al. (2021) and Herath et al. (2023), provide complementary insights. These studies found that structured and data-driven revenue management enhances profitability and transparency. However, they also emphasized the need for discipline and objective systems. The current study's findings suggest that in the absence of such structured frameworks, revenue management may shift from strategic optimization to opportunistic earnings smoothing, thereby reducing financial reporting quality.

Further, Nyaga (2023) emphasized the importance of organizational capabilities, managerial competence, and technological systems in determining whether revenue management practices improve performance or facilitate earnings manipulation. This perspective is consistent with the results of the present study, which show that where managerial discretion dominates, revenue management tends to reduce financial reporting quality. Similarly, Onyango and Nguthi (2025) observed that modern revenue management integrates customer analytics, behavioral pricing, and forecasting models. While these tools enhance strategic decision-making, they also introduce subjectivity, which can compromise financial reporting integrity if not properly governed.

From a theoretical perspective, these findings are strongly supported by Positive Accounting Theory. The theory posits that managers choose accounting methods that maximize their personal utility, often influenced by compensation contracts, debt covenants, or political costs. The negative relationship between revenue management and financial reporting quality suggests that managers may manipulate revenue recognition to achieve desired earnings targets, confirming the opportunistic behavior predicted by positive accounting theory.

The results also align with Agency Theory, which explains the conflict of interest between managers (agents) and shareholders (principals). Managers may engage in revenue smoothing or discretionary revenue recognition to present favorable financial outcomes, protect their positions, or secure bonuses. Such behavior increases information asymmetry and reduces the reliability of financial statements. The significant negative effect of revenue management on reporting quality supports the agency theory argument that managerial discretion, when unchecked, leads to opportunistic reporting practices.

Additionally, the findings are consistent with Legitimacy Theory, which suggests that organizations attempt to maintain social acceptance and legitimacy by presenting favorable financial performance. Banks may engage in revenue management to project stability, profitability, and growth in order to maintain investor confidence, regulatory approval, and public trust. However, when such practices distort the true financial position of the bank, they undermine the credibility of financial reporting. The observed negative relationship indicates that attempts to maintain legitimacy through revenue smoothing may actually compromise reporting quality.

Overall, the empirical results reinforce the literature's central argument that revenue management has dual effects. While it can serve as a strategic tool for performance optimization, excessive managerial discretion often transforms it into a mechanism for earnings manipulation. The findings confirm that in the context of Kenya's listed commercial banks, revenue management is more closely associated with opportunistic reporting behavior, thereby reducing financial reporting quality. This underscores the importance of strong corporate governance, effective internal controls, and strict adherence to accounting standards such as IFRS 15 to ensure that revenue management supports genuine performance rather than distorting financial information.

**4.5.2 Asset Management and Financial Reporting Quality**

The empirical findings of this study demonstrate that asset management has a statistically significant and negative effect on financial reporting quality among listed commercial banks in Kenya. The random effects regression results show a coefficient of −0.3719 ($p < 0.001$), implying that increases in abnormal asset growth significantly reduce financial reporting quality. This indicates that discretionary asset-related decisions, such as aggressive asset expansion, delayed impairment recognition, or strategic reclassification of loan portfolios, tend to distort reported earnings and weaken the credibility of financial statements. These results suggest that asset management practices, when driven by managerial discretion rather than prudential considerations, compromise transparency and reliability in financial reporting.

These findings are consistent with the broader literature on asset management and firm performance. Owusu and Alhassan (2021) found that strategic asset–liability management enhances bank profitability, but also revealed that higher asset returns often coincide with increased liability costs, reflecting deliberate managerial balancing. While their study focused on profitability rather than reporting quality, the present findings extend this argument by demonstrating that when asset management decisions are overly aggressive or poorly aligned, managers may resort to discretionary accounting adjustments to maintain favorable financial outcomes, thereby reducing reporting quality.

Similarly, Al-Sadi and Al-Mamouri (2022) reported that effective asset management improves bank profitability by maintaining asset quality and reducing non-performing loans. However, their study did not incorporate governance or disclosure mechanisms. The current study’s negative coefficient for asset management suggests that without strong governance frameworks, even profitability-enhancing asset strategies may encourage earnings manipulation through delayed provisioning or overstated asset values, thus undermining financial reporting quality.

The findings also resonate with Purba and Bimantara (2020), who established a positive relationship between asset management efficiency and firm performance using panel data. While their results emphasize operational efficiency, they do not address how such efficiency is reflected in financial disclosures. The present study bridges this gap by showing that abnormal asset growth, often indicative of discretionary asset expansion, can be associated with reduced reporting quality when transparency and controls are weak.

From a systems perspective, Maletič et al. (2020) emphasized that structured asset management practices anchored in strategic alignment and risk management enhance sustainability and performance. These principles are equally applicable to financial reporting. The negative relationship observed in this study suggests that when asset management lacks structure and discipline, it increases informational asymmetry and creates room for discretionary reporting, thereby lowering financial reporting quality.

Likewise, Gajisan and Gatawa (2023) linked asset management efficiency to improved firm performance and market valuation. However, the absence of governance and disclosure considerations limits the extent to which such performance reflects true financial health. The current study demonstrates that in banking, asset efficiency alone is insufficient; without transparent reporting and effective oversight, asset management can be used opportunistically to manipulate earnings through misstatement of impairments and provisioning.

The findings also align with Syaifudin et al. (2020), who identified leadership, competence, and internal controls as key determinants of effective asset management. Although their study focused on the public sector, it underscores the importance of institutional discipline in ensuring accurate asset valuation and reporting. In the banking context, weak internal controls over asset recognition and impairment increase the likelihood of earnings manipulation, which is reflected in lower financial reporting quality.

From a theoretical standpoint, the results strongly support Positive Accounting Theory, which posits that managers choose accounting methods that maximize personal utility. Abnormal asset growth may be used strategically to inflate reported earnings or delay losses, consistent with opportunistic behavior predicted by the theory. The significant negative effect of asset management on reporting quality suggests that managers exploit discretion in asset valuation and provisioning to achieve desired financial outcomes.

The findings are also well explained by Agency Theory. Managers, acting as agents, may prioritize short-term performance targets or compensation incentives over the long-term interests of shareholders. This conflict encourages aggressive asset expansion or delayed recognition of impairments, increasing information asymmetry and reducing the reliability of financial statements. The negative relationship observed confirms that unchecked managerial discretion in asset management adversely affects financial reporting quality.

Furthermore, the results are consistent with Legitimacy Theory, which argues that firms seek to maintain societal approval by portraying financial stability and growth. Banks may manipulate asset-related figures to signal strength, stability, and compliance with regulatory expectations. However, such practices, while enhancing perceived legitimacy in the short term, ultimately compromise the credibility and quality of financial reporting.

In synthesis, both empirical and theoretical evidence indicate that asset management plays a dual role in banking. While prudent asset management enhances operational performance, discretionary and abnormal asset growth undermines financial reporting quality when governance mechanisms are weak. For Kenya's listed commercial banks, where loans and advances dominate the asset base, effective oversight, strict adherence to impairment standards (such as IFRS 9), and robust internal controls are critical to ensuring that asset management supports transparency rather than facilitating earnings manipulation.

### 4.5.3 Debt Management and Financial Reporting Quality

The findings of this study indicate that debt management has a statistically significant and negative effect on financial reporting quality among listed commercial banks in Kenya. The random effects regression results show a coefficient of −0.2857 ($p < 0.001$), implying that an increase in debt management practices—measured through loan loss provisions to gross total loans—leads to a decline in financial reporting quality by approximately 28.57%. This result suggests that discretionary adjustments in loan loss provisions and debt-related accounts are used by managers to smooth earnings, meet regulatory or covenant thresholds, or present a more stable financial position, thereby reducing the reliability and transparency of financial statements.

These results are consistent with the conceptual link established by Amrah and Hashim (2020), who found that higher financial reporting quality is associated with a lower cost of debt. Their findings imply that transparent and accurate reporting reduces information asymmetry and enhances lenders' confidence. The current study complements this perspective by showing the inverse: when debt management practices become more discretionary, financial reporting quality declines. This suggests that opportunistic provisioning or liability adjustments may increase information asymmetry, thereby undermining the credibility of financial statements and potentially increasing borrowing costs.

Similarly, Etoromat (2022) emphasized the importance of debt management literacy in enhancing financial performance within SACCOs. Although the study focused on cooperative institutions rather than commercial banks, its findings reinforce the importance of sound debt governance. The present study extends this insight by demonstrating that in the absence of disciplined and transparent debt management practices, managers may manipulate loan loss provisions or debt classifications to achieve desired earnings outcomes, thus compromising reporting quality.

The findings also resonate with Valaskova and Gajdosikova (2021), who identified a non-linear relationship between leverage and firm performance. Their study showed that optimal levels of indebtedness support profitability, while excessive leverage increases financial distress and reporting pressure. In the context of the current study, high levels of debt or aggressive provisioning practices may place pressure on managers to manipulate financial results in order to meet performance targets or covenant requirements. This supports the observed negative relationship between debt management and financial reporting quality.

Within the Kenyan context, Owich and Mutswenje (2021) found that effective debt management practices, such as credit assessment, loan reviews, and collateral management, improve loan performance in banks. However, their study did not examine the reporting implications of such practices. The current study fills this gap by showing that when debt management involves discretionary provisioning or reclassification of liabilities, it may distort earnings and reduce reporting quality. This indicates that operational efficiency in debt management must be complemented by transparent accounting practices and strong governance mechanisms.

Collectively, the reviewed studies and the empirical findings of this research point to three key mechanisms through which debt management affects financial reporting quality. First, provisioning discretion allows managers to adjust loan loss provisions to smooth earnings or meet regulatory requirements. Second, liability classification and covenant management may enable managers to restructure or reclassify debt in ways that conceal actual leverage levels. Third, market discipline suggests that transparent debt reporting reduces borrowing costs, whereas opaque reporting practices erode stakeholder confidence. The negative coefficient observed in this study provides empirical support for these mechanisms, indicating that discretionary debt management practices are associated with lower financial reporting quality.

From a theoretical perspective, the findings strongly align with Positive Accounting Theory. This theory suggests that managers select accounting methods that maximize their own utility, particularly under conditions of debt covenants and performance pressures. Loan loss provisions are a well-documented tool for earnings management in banking. The negative effect of debt management on financial reporting quality suggests that managers may be using provisioning and liability adjustments opportunistically to avoid covenant violations, smooth earnings, or secure compensation incentives.

The results are also consistent with Agency Theory, which highlights the conflict of interest between managers (agents) and shareholders or creditors (principals). Managers may manipulate debt-related accounts to present a more favorable financial position, thereby protecting their personal interests, such as job security or performance-based compensation. Such actions increase information asymmetry and reduce the credibility of financial statements, as evidenced by the significant negative relationship between debt management and financial reporting quality.

Furthermore, the findings can be interpreted through the lens of Legitimacy Theory. Banks operate in a highly regulated environment where maintaining public confidence and regulatory approval is essential. To preserve legitimacy, managers may engage in debt-related earnings management practices to portray financial stability, solvency, and compliance with regulatory capital requirements. While such practices may temporarily enhance the institution's perceived legitimacy, they ultimately compromise the accuracy and transparency of financial reports.

In summary, both the empirical findings and the reviewed literature suggest that debt management plays a critical role in shaping financial reporting quality. While prudent and transparent debt management enhances credibility and reduces borrowing costs, discretionary provisioning and liability manipulation undermine reporting integrity. The results of this study confirm that in Kenya's listed commercial banks, increased debt management discretion is associated with lower financial reporting quality. Strengthening corporate governance, enhancing regulatory oversight, and enforcing strict provisioning standards are therefore essential to ensure that debt management practices support, rather than compromise, the credibility of financial reporting.

**4.5.4 Expense Management and Financial Quality**

The empirical results of this study indicate that expense management has a statistically significant and negative effect on financial reporting quality among listed commercial banks in Kenya. The random effects regression analysis shows a coefficient of −0.2140 ($p < 0.001$), implying that an increase in expense management practices, measured through the operating expense provisions to total income ratio heads to a decline in financial reporting quality by approximately 21.40%. This finding suggests that discretionary control over expense recognition, classification, and provisioning is frequently used to manage reported earnings, thereby reducing the transparency and faithful representation of financial statements.

These results are consistent with the broader empirical literature on cost management and financial performance. Djurakulovna (2025) demonstrated that income and expense dynamics are central to bank performance, highlighting how cost efficiency improves profitability and financial stability. While the study focused on performance outcomes rather than reporting quality, the present findings extend this insight by showing that when expense management becomes excessively discretionary, it shifts from efficiency enhancement to earnings manipulation, thus weakening financial reporting quality.

Similarly, Safitri and Machmuddah (2025) found that operating expenses exert a significant negative effect on bank profitability in Indonesia. Their results reinforce the idea that expense levels are a critical driver of reported outcomes. However, their reliance on cross-sectional data limits the ability to observe how expense manipulation evolves over time. The current study addresses this gap by employing longitudinal panel data, demonstrating that sustained discretionary expense management practices are associated with persistent reductions in financial reporting quality.

The findings also align with Erasmus (2021), who showed that structured cost management techniques, such as activity-based costing and standard costing, enhance profitability and reporting accuracy among Nigerian banks. This supports the argument that disciplined and systematic expense management improves transparency. In contrast, the negative coefficient observed in this study suggests that where expense management lacks structure and is driven by managerial discretion, it facilitates income smoothing and distorts financial reporting outcomes.

Further support is provided by Ghanbari et al. (2022), who found that strategic cost management positively moderates the relationship between operational efficiency and financial performance. Their results indicate that disciplined expense control enhances transparency and reporting quality. However, their manufacturing-sector focus limits direct applicability to banking. The present study extends these findings to the banking sector, demonstrating that when expense management is not strategically disciplined but instead used opportunistically, it adversely affects financial reporting quality.

From a theoretical perspective, the results strongly support Positive Accounting Theory, which posits that managers select accounting policies that maximize personal utility. Discretionary expense provisions offer managers an effective tool for earnings smoothing and bonus maximization. The significant negative relationship between expense management and financial reporting quality indicates that managers may exploit expense-related accruals to influence reported earnings in line with self-interest.
The findings are also consistent with Agency Theory, which emphasizes conflicts of interest between managers and principals. Managers may manipulate expense recognition to meet short-term performance targets, protect compensation, or signal stability, thereby increasing information asymmetry. The observed decline in reporting quality reflects the agency problem inherent in discretionary expense management, particularly in the absence of strong monitoring and governance mechanisms.

In addition, the results align with Legitimacy Theory. Commercial banks operate under intense regulatory and public scrutiny, creating incentives to present stable and favorable financial outcomes. Managers may engage in expense smoothing or reclassification to maintain legitimacy in the eyes of regulators, investors, and depositors. While such practices may preserve institutional legitimacy in the short term, they ultimately undermine the credibility and reliability of financial reports.

In synthesis, both empirical evidence and theory suggest that expense management plays a dual role in banking. When anchored in transparent cost allocation and disciplined provisioning, it enhances operational efficiency and reporting quality. However, when driven by opportunistic discretion, expense management becomes a mechanism for earnings manipulation, reducing financial reporting quality. The findings of this study confirm that in Kenya’s listed commercial banks, higher levels of discretionary expense management are associated with lower-quality financial reporting, underscoring the need for stronger governance, clearer expense recognition guidelines, and enhanced regulatory oversight.

### 4.6 Random Effect Model with Corporate Governance

To examine the moderating effect of corporate governance on the relationship between earnings management practices and financial reporting quality, an interaction model was estimated using the random effects approach. The selection of the random effects model was guided by the Hausman specification test, which indicated that the random effects estimator was more appropriate and efficient for the panel data structure.

In this moderated model, corporate governance was introduced both as an independent variable and as an interaction term with earnings management. The purpose of the interaction terms was to determine whether the strength or direction of the relationship between earnings management practices and financial reporting quality changes at different levels of corporate governance. Table 4.9 shows the results of the moderation effect of corporate governance on the relationship between earnings management and financial reporting quality of listed commercial banks in Kenya.

**Table 4.4:** Random Effect Model

| Variable | Coef. | Std. Err. | T | P>/z/ |
|---|---|---|---|---|
| CG | .6127 | .1462 | 4.19 | 0.001 |
| EM | -.3812 | .0913 | -4.18 | 0.002 |
| EM*CG | .4796 | .0611 | 7.85 | 0.003 |
| Con. | .7162 | .1085 | 6.61 | 0.001 |
| | Within<br>Between<br>Overall | = 0.6723<br>= 0.6472<br>= 0.6315 | Wald chi2(3)<br>Prob>chi2 | = 323.47<br>=0.0000 |

**Source:** Stata (2026).

The results presented in Table 4.9 show the random effects model used to test the moderating role of corporate governance in the relationship between earnings management and financial reporting quality among listed commercial banks. The model is statistically significant, as indicated by the Wald chi$^2$ value of 323.47 with a Prob > chi$^2$ of 0.0000, which is below the 0.05 significance level. This confirms that the variables in the model jointly explain variations in financial reporting quality. The overall R-squared value of 0.6315 indicates that 63.15% of the changes in financial reporting quality are explained by corporate governance, earnings management, and their interaction, while the remaining 36.85% is influenced by other factors not included in the model. The study's moderated variable is shown in equation 4.2 below.

$$FRQ_{it} = 0.7162 + 0.6127CG_{it} - 0.3812EM_{it} + 0.4796EM_{it}.CG_{it}$$

The constant (intercept) in equation 4.2 is 0.7162 with a p-value of 0.001, which indicates that it is statistically significant at the 5% level. The constant represents the expected level of financial reporting quality when all the independent variables in the model, corporate governance (CG), earnings management (EM), and the interaction term (EM × CG), are equal to zero. This means that, in the absence of earnings management and corporate governance influences, the baseline level of financial reporting quality would be approximately 0.7162 units. The statistical significance of the constant suggests that there are other underlying factors, not captured by the model variables, that contribute positively to financial reporting quality in listed commercial banks.

### 4.6.1 Corporate Governance and Financial Reporting Quality

The results in Table 4.9 indicate that corporate governance has a positive and statistically significant effect on financial reporting quality, with a coefficient of 0.6127 ($p < 0.001$). This implies that stronger corporate governance mechanisms, such as effective board oversight, independent audit committees, and robust internal control systems, significantly enhance the transparency, reliability, and credibility of financial reports among listed commercial banks. Holding earnings management constant, an improvement in corporate governance leads to an improvement in financial performance by 61.27%. This finding suggests that sound governance structures constrain managerial opportunism, strengthen monitoring, and promote compliance with accounting standards, thereby improving the quality of reported financial information.

This result is strongly grounded in agency theory, which posits that the separation of ownership and control creates incentives for managers to engage in opportunistic behavior, including earnings management. In the banking context, where managers exercise substantial discretion over accounting estimates and provisions, weak monitoring increases the risk of financial misreporting. The positive effect of corporate governance demonstrates that effective governance mechanisms mitigate agency conflicts by enhancing managerial oversight and reducing information asymmetry between managers and shareholders. Consequently, financial reports more accurately reflect the underlying economic performance of banks.

The finding also aligns with positive accounting theory, which argues that managers select accounting policies that maximize their own utility when discretion is unconstrained. Strong corporate governance limits such opportunistic accounting choices by imposing discipline through monitoring, compliance, and accountability structures. The significant positive coefficient indicates that governance mechanisms constrain earnings manipulation and encourage the adoption of accounting practices that enhance the objectivity and consistency of financial reporting.

Further, from a legitimacy theory perspective, the result suggests that listed commercial banks use corporate governance as a strategic tool to maintain legitimacy with regulators, investors, and the wider public. Given the highly regulated nature of the banking sector in Kenya, adherence to strong governance frameworks signals compliance with regulatory expectations, ethical standards, and societal norms. Improved financial reporting quality enhances stakeholder confidence and reinforces the institutional legitimacy of banks operating in a competitive and closely monitored environment.

### 4.6.2 Earnings Management and Financial Reporting Quality

Earnings management shows a negative and statistically significant relationship with financial reporting quality, with a coefficient of −0.3812 ($p < 0.002$). This indicates that an increase in earnings management practices leads to a 38.12% reduction in financial reporting quality, suggesting that manipulation of accounting figures compromises the accuracy, transparency, and reliability of financial statements. In practical terms, this means that when bank managers exercise greater discretion in adjusting accruals, provisions, or expense recognition to influence reported earnings, the credibility and usefulness of financial reports decline significantly.

This finding implies that earnings management distorts the true financial position and performance of banks by smoothing income, deferring losses, or accelerating revenues. Such practices create a gap between reported accounting numbers and the underlying economic reality, thereby reducing the decision usefulness of financial statements for investors, regulators, and other stakeholders. As a result, stakeholders may make suboptimal decisions based on misleading financial information, increasing the risk of mispricing, regulatory sanctions, or reputational damage.

From an agency theory perspective, the negative relationship reflects the opportunistic behavior of managers who exploit information asymmetry to pursue personal interests, such as performance-based compensation, job security, or reputation, at the expense of shareholders and other stakeholders. In the absence of effective monitoring mechanisms, managers may engage in discretionary accounting practices that conceal poor performance or artificially inflate earnings, thereby reducing financial reporting quality.

The finding is also consistent with positive accounting theory, which posits that managers select accounting policies that maximize their own utility when given discretion. Under this theory, managers are likely to manipulate earnings to meet debt covenants, achieve bonus targets, or avoid political and regulatory scrutiny. The significant negative coefficient confirms that such opportunistic accounting choices materially reduce the quality, neutrality, and faithful representation of financial reports. From the perspective of legitimacy theory, excessive earnings management undermines the social contract between banks and their stakeholders. Financial institutions rely heavily on public trust, regulatory approval, and investor confidence. When earnings manipulation becomes prevalent, it threatens the perceived legitimacy of the institution, as stakeholders begin to question the integrity and transparency of its financial disclosures. This can lead to loss of investor confidence, regulatory intervention, and reputational damage.

Overall, the significant negative effect of earnings management confirms that discretionary accounting practices are detrimental to financial reporting quality. The result underscores the importance of strong governance mechanisms, robust internal controls, and strict regulatory oversight in limiting opportunistic earnings manipulation and promoting transparent, reliable, and high-quality financial reporting within listed commercial banks.

### 4.6.3 The Moderation Effect of Corporate Governance on the Relationship between Earnings Management and Financial Reporting Quality

The interaction term between earnings management and corporate governance (EM × CG) is positive and statistically significant, with a coefficient of 0.4796 ($p < 0.003$). This finding indicates that corporate governance significantly moderates the relationship between earnings management and financial reporting quality. Specifically, robust corporate governance mechanisms attenuate the adverse effects of earnings management on the quality of financial reporting. In practical terms, while earnings management independently exerts a negative influence on reporting quality, the presence of effective governance structures mitigates this effect by constraining managerial discretion, enhancing oversight, and promoting transparent and accountable accounting practices. Consequently, the detrimental impact of earnings management on financial reporting quality is substantially reduced in banks with strong governance frameworks.

From an agency theory perspective, this finding demonstrates the monitoring role of corporate governance in reducing agency conflicts between managers and shareholders. Governance mechanisms such as independent boards, audit committees, and effective internal controls act as monitoring tools that constrain opportunistic managerial behavior. Consequently, even when managers attempt to engage in earnings management, strong governance structures reduce the extent to which such practices distort financial reports.

In line with positive accounting theory, managers are assumed to select accounting policies that maximize their personal utility. However, the presence of strong governance mechanisms imposes constraints on opportunistic accounting choices. The significant positive interaction term suggests that corporate governance acts as a disciplining mechanism, limiting the extent to which managers can manipulate earnings through discretionary accruals and expense adjustments. Therefore, governance structures reduce the negative reporting consequences predicted by positive accounting theory.

From the perspective of legitimacy theory, strong corporate governance enhances the credibility and acceptability of financial reports in the eyes of stakeholders. Effective governance signals a commitment to transparency, accountability, and ethical financial practices. As a result, even in the presence of earnings management pressures, well-governed banks are better able to maintain stakeholder confidence and institutional legitimacy. The moderating effect of governance, therefore, reflects its role in safeguarding the integrity of financial disclosures and preserving public trust.

Overall, the positive and significant interaction between earnings management and corporate governance confirms that governance structures play a critical buffering role. While earnings management tends to undermine financial reporting quality, strong corporate governance mechanisms mitigate this adverse effect, promoting more transparent, reliable, and credible financial reporting in listed commercial banks.

## 5. Conclusions and Recommendations

### 5.1 Conclusions

Based on the findings of the study, the following conclusions are drawn:

The study concludes that earnings management through practices such as revenue smoothing, abnormal asset growth, discretionary debt provisioning, and expense manipulation significantly reduces the quality of financial reporting in listed commercial banks in Kenya. This indicates that managerial discretion, when misaligned with regulatory and shareholder expectations, compromises the accuracy, transparency, and reliability of financial statements.

Among the components of earnings management, revenue management and asset management have the strongest negative impact on financial reporting quality. Banks that engage in aggressive revenue recognition or manipulate asset valuations are most likely to compromise the credibility of their financial statements. This highlights areas where regulatory scrutiny and internal monitoring are most critical.

Debt and expense management were found to have a significant but comparatively moderate negative effect on financial reporting quality. Discretionary loan-loss provisioning, liability reclassification, and manipulative expense recognition can distort reported earnings, emphasizing the need for consistent and transparent accounting practices.

The study finds that robust corporate governance significantly mitigates the negative effects of earnings management. Banks with effective boards, independent audit committees, and strong internal controls are better able to constrain managerial discretion, enforce accurate reporting, and enhance stakeholder confidence. This underscores the critical role of governance in safeguarding financial reporting integrity. The results support agency theory, illustrating that managers may act in self-interest, and effective governance aligns their actions with shareholder goals. Positive accounting theory is also supported, showing that managerial choices in accounting can be opportunistic, but regulatory and governance mechanisms can constrain such behavior. Finally, legitimacy theory is reinforced, as transparent reporting and strong governance enhance the credibility and societal acceptance of banks' financial statements.

**5.2 Recommendations**

Based on the findings of this study, several recommendations are proposed for practitioners, regulators, and future research to enhance financial reporting quality in Kenyan commercial banks.

First, commercial banks should strengthen corporate governance structures to mitigate the negative effects of earnings management. The study shows that strong governance, through independent boards, active audit committees, and effective internal controls, significantly improves the transparency, reliability, and credibility of financial reporting. Banks should, therefore, ensure that governance policies are not only in place but are actively monitored and periodically evaluated to adapt to emerging risks and changes in regulatory requirements.

Second, banks should implement stringent internal monitoring and reporting systems to curb opportunistic earnings management. Revenue recognition, asset valuation, debt provisioning, and expense reporting procedures should be standardized and closely supervised to prevent discretionary manipulation. Training programs on ethical accounting practices, IFRS compliance, and transparent reporting can further reinforce managerial discipline, reducing the likelihood of earnings manipulation.

Third, regulators, including the Central Bank of Kenya and the Capital Markets Authority, should enhance oversight and enforcement mechanisms. By conducting regular assessments of governance effectiveness, monitoring key financial reporting indicators, and enforcing compliance with reporting standards, regulators can strengthen market confidence and ensure that financial statements reflect the true financial position of banks.

Fourth, integration of risk management with accounting practices is essential. Banks should adopt disciplined debt and asset management strategies, implement accurate expense recognition protocols, and utilize automated reporting systems to minimize human discretion in accounting judgments. Such practices not only improve operational efficiency but also enhance the credibility and transparency of financial statements.

Fifth, stakeholders, including investors and auditors, should prioritize governance and reporting quality when evaluating banks. Investment and lending decisions should consider the strength of corporate governance mechanisms, historical earnings management patterns, and the robustness of internal controls to better assess financial reliability.



**Conflict of Interest Statement**
The authors declare no conflicts of interest.

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