

**THE EFFECT OF SOCIAL AND ENVIRONMENTAL  
ACCOUNTING AND REPORTING ON THE FINANCIAL  
PERFORMANCE OF COMPANIES LISTED ON THE NAIROBI  
SECURITIES EXCHANGE**

**ALPHONSE OMOLLO ODHIAMBO**

**D61/79074/2012**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE  
REQUIREMENTS OF MASTER OF BUSINESS ADMINISTRATION,  
UNIVERSITY OF NAIROBI**

**OCTOBER, 2015**

## DECLARATION

This research project is my own original work and it has not been submitted anywhere for any award of a degree or diploma. Where other sources of information have been used, they have been acknowledged.

Signature: .....

Date.....

Name: Odhiambo Alphonse Omollo

**Reg. No.D61/79074/2012**

This research project has been submitted for examination with my approval as the university supervisor.

Signature .....

Date .....

Name: Abdulatiff Essajee

Lecturer, School of Business

University of Nairobi

## **ACKNOWLEDGEMENT**

First and foremost, I would like to thank God for the strength He gave me to carry out this research work. Secondly, I would like to thank my supervisor Mwalimu Abdulatiff Essajee for the guidance and cooperation he accorded me throughout this research project. This project could not have been completed on time without his help and support. Special gratitude also goes to my parents for standing by my side in the quest for education. My wife Eunice and brother Victor and sister Vincentia who provided exceptional support that gave the much-needed confidence and motivation to soldier on even when the going was tough.

## **DEDICATION**

I dedicate this work to my parents who have always taught me how to live, respect and value life and to my wife Eunice for the encouragement and support throughout my studies.

## **TABLE OF CONTENTS**

<b>DECLARATION.....</b>	<b>i</b>
<b>ACKNOWLEDGEMENT.....</b>	<b>ii</b>
<b>DEDICATION.....</b>	<b>iii</b>
<b>TABLE OF CONTENTS .....</b>	<b>iv</b>
<b>List of Abbreviations .....</b>	<b>viii</b>
<b>List of Tables .....</b>	<b>ix</b>
<b>ABSTRACT.....</b>	<b>x</b>
<b>CHAPTER ONE: INTRODUCTION.....</b>	<b>1</b>
1.1 Background of the Study .....	1
1.1.1 Social and Environmental Accounting and Reporting.....	1
1.1.2 Financial Performance of Companies .....	6
1.1.3 Relationship between Social and Environmental Accounting and Reporting and Financial Performance .....	7
1.1.4 Nairobi Securities Exchange.....	8
1.2 Research Problem .....	10
1.3 Research Objective .....	12
1.4 Value of the Study .....	12
<b>CHAPTER TWO: LITERATURE REVIEW.....</b>	<b>14</b>
2.1 Introduction.....	14

2.2 Theoretical Framework.....	14
2.2.1 Conceptual Theories for Social and Environmental Accounting .....	14
2.2.1.1 Stakeholder Theory .....	15
2.2.1.2 Legitimacy Theory .....	17
2.2.1.3 Accountability Theory .....	18
2.2.1.4 Political Economy Theory .....	19
2.2.2 Classification/Forms of Social and Environmental Accounting.....	19
2.2.2.1 National Social Income Accounting (Macro Accounting) .....	20
2.2.2.2 Social Auditing Approach.....	20
2.2.2.3 Financial/Managerial Social Accounting for Non-profit Entities.....	20
2.2.2.4 Financial Social Accounting .....	21
2.2.2.5 Managerial Social Accounting.....	21
2.2.3 Modes of Disclosures.....	21
2.2.3.1 Descriptive Approach .....	22
2.2.3.2 Cost of Outlay Approach .....	22
2.2.3.3 Cost Benefit Approach.....	22
2.3.1 Determinants of Corporate Social Responsibility Accounting.....	23
2.3.2 Determinants of Financial Performance .....	23

2.4 Empirical Studies .....	24
2.4.1 Global Studies .....	24
2.4.2 Local Studies.....	25
2.5 Summary of Literature Review .....	27
<b>CHAPTER THREE: RESEARCH METHODOLOGY .....</b>	<b>29</b>
3.1 Introduction.....	29
3.2 Research Design.....	29
3.3 Population .....	29
3.4 Data Collection .....	30
3.5 Data Analysis .....	30
<b>CHAPTER FOUR: DATA ANALYSIS AND FINDINGS.....</b>	<b>32</b>
4.1 Introduction.....	32
4.2 Descriptive Analysis .....	32
4.2.1 Adoption of Social and Environmental Accounting and Reporting .....	33
4.2.2 Areas of Social and Environmental Accounting Reported .....	33
4.2.3 Format for Reporting .....	34
4.2.4 Framework Followed in Reporting.....	34
4.3 Regression Analysis and Hypothesis Testing .....	34

4.4 Discussion of Research Findings .....	35
<b>CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS ..</b>	<b>37</b>
5.1 Introduction.....	37
5.2 Summary of the Findings.....	37
5.3 Conclusion .....	38
5.4 Recommendation .....	39
5.5 Limitations of the Study.....	39
5.6 Suggestions for Further Research .....	40
<b>REFERENCES.....</b>	<b>41</b>
<b>APPENDICES .....</b>	<b>46</b>



## **List of Abbreviations**

<b>CDSB</b>	Climate Disclosure Standard Board
<b>CSR</b>	Corporate Social Responsibility
<b>EMCA</b>	Environment Management and Coordination Act
<b>GNP</b>	Gross National Product
<b>GRI</b>	Global Reporting Initiative
<b>ICPAK</b>	Institute of Certified Public Accountants of Kenya
<b>IIRC</b>	International Integrated Reporting Council
<b>IR</b>	Integrated Reporting
<b>ISEA</b>	Institute of Social and Ethical Accountability
<b>MNCs</b>	Multinational Corporations
<b>NEMA</b>	National Environment Management Authority
<b>NSE</b>	Nairobi Stock Exchange
<b>NYSE</b>	New York Securities Exchange
<b>PCP</b>	Polyvocal Citizenship Perspective
<b>PPBS</b>	Planning, Programming, Budgeting Systems
<b>UK</b>	United Kingdom
<b>UNEP</b>	United Nations Environmental Programme

## **List of Tables**

Table 1: Companies that have Adopted Social and Environmental Accounting.....	33
Table 2: Areas of Social and Environmental Accounting Reported.....	33
Table 3: Format for Reporting.....	34

## **ABSTRACT**

Profit and shareholders wealth maximization have for long dictated accounting and reporting practices, increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance have given rise to the need for environmental and social accounting and reporting. The research aimed at determining the areas of social and environmental activities reported and the format used to report in the annual financial reports of the companies listed in the Nairobi Securities Exchange. It also aimed at determining if the companies were following the various frameworks that were available for reporting on the impact of their economic activities on the society and environment like the Global Reporting Initiative (GRI) reporting guidelines. The research also aimed at determining whether by accounting and reporting on their social and environmental activities this had an effect on the firm's financial performance as measured by the Return on Assets. The population of the study comprised of sixty four companies quoted in NSE as at December 2014. Census method was used to collect data. Secondary data was collected from published annual financial statement of all listed companies. Content analysis and regression analysis were used in analyzing data. It was established in the year 2011, companies practicing social and environmental accounting and reporting were 60%, while in 2012 they were 63% and while in 2013 they were 68%. It was also established that most companies reported their social and environmental activities using a monetary form of presentation even though they did not follow any reporting guideline. Lastly, it was observed that there exists a relationship between social and environmental accounting and reporting and financial performance of companies listed in the NSE. Regression analysis was used to test the relationship between social and environmental accounting and reporting and financial performance while using capital intensity and efficiency as control independent variables. The study found that CSR score, efficiency and capital intensity had a positive relationship with financial performance of companies listed in the NSE. The study found an increase in CSR score would lead to increase in financial performance and also revealed that a unit increase in efficiency would lead to increase in financial performance. The research also determined that a unit increase in capital intensity would lead to increase in financial performance of the companies listed in the NSE.

## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background of the Study**

There have been many attempts to experiment with accounting statements that reflect economic, social and environmental issues, however their take-up has been slow or non-existent. Outside of the Value Added Statement, the accounting profession has not supported any of these developments (Bebbington et al., 2001). Gore (2006) identified two explanatory factors to explain why accounting bodies have not initiated change in this area. First, he found that the separation of financial and management accounting bodies meant that many accounting bodies did not feel that these issues (characterized as management accounting issues) were within their mandate. Secondly, he suggested that they first had to meet the industry demand, and as such industry interest would drive the accounting profession's interest.

Social accounting for instance provides guidelines and tools to collect, analyse and monitor financial, social and environmental data (and thus guide behaviour). Although accounting as a professional field has a lengthy history dating back to at least the mid-nineteenth century (Tinker, 1985), social and environmental accounting and reporting is more recent and burgeoned during the early 1970s (Mathews, 2007).

#### **1.1.1 Social and Environmental Accounting and Reporting**

The sole aim of establishing an organization is to improve the quality of life in the society. Measures need to be put in place that determine and reports the extent to which the organization has impacted on the society from time to time. This has been the basic function of the accounting systems of organizations (Francis, 1990).

An accounting system is an information providing system that gathers data, analyses and interprets the data and communicates the results to the end users in order to aid socio-economic decisions that could help in improving the quality of life in its totality (Gray et al., 1996). The conventional accounting systems have often been reported to be biased in

what they report and to the people they serve. The conventional accounting systems have tended to deal more with and report on transactions that are financial in nature (Robson, 1991). They also mostly address the needs of the private users of information (shareholders, creditors, investors, governments, employees, management etc.) Gray et al. (1988) argues that conventional accounting systems have suppressed this conflict of needs by taking on a passive role and implicitly 'preferencing' the rights of investors (Oduol, 2009).

However, social accounting and reporting by its very key nature addresses the question: for whom should we be accounting for and how best should we account for them? It opens up dialogue with far broader range of 'users' than just the investor/ shareholder. The conventional accounting systems do not address the combined issues of the society and how the organizations impact on them (Oduol, 2009).

In order for the accounting systems to be effective, they must change their orientation and play a role that would emphasize their esteemed social importance in the society. Sachar Committee as given in Narang et al. (2007) observed that organizations need to focus accountability to the larger society and not just to shareholders. An accounting approach is, therefore needed that will tend to bridge the gap that the conventional accounting systems have created between the organizations and the society. Social accounting challenges conventional accounting in particular financial accounting, for giving a narrow image of the interaction between society and organizations and thus artificially constraining the subject of accounting (Crowther, 2000).

Social and environmental accounting is a broad term that includes a variety of alternative accounting models, including expanded value added accounting, environmental accounting, and sustainability accounting (Friedman, 1970). Social accounting is the process whereby organizations account for their social, environmental and economic impacts (Oduol, 2009). External social accounting seeks to demonstrate how the reporting organization integrates with the society and systems within which it operates. Internal social (management) accounting seeks to provide information to help an

organization's managers operate in a more socially sustainable manner. Ideally, these internal and external social accounting processes are not completely separate from the mainstream financial or management accounting processes within an organization, and both sustainability and financial employees would be involved in collecting and presenting the data (Oduol, 2009).

Social accounting and reporting, a largely normative concept, seeks to broaden the scope of accounting in the sense that it: concerns itself with more than only economic events; is not exclusively expressed in financial terms; is accountable to a broader group of stakeholders; broadens its purpose beyond financial success. It points to the fact that companies influence their external environment (both positively and negatively) through their actions and should therefore account for these effects as part of their standard accounting practices. Social accounting and reporting in this sense is closely related to the economic concept of externality. Social accounting and reporting offers an alternative account of significant economic entities. It has the potential to expose the tension between pursuing economic profit and the pursuit of social and environmental objectives (Gray et al., 1996a).

Social accounting is a branch of accounting which attempts to measure the social benefits that an organization provides and the social costs that an organization incurs, with a view of using such to make available information that would enhance appropriate allocation of scarce resources for the benefit of the organization and the society (Kalunda, 2007). Crowther (2000) considers social accounting as an approach to reporting a firm's activities that stresses the need for identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques.

In Social accounting the focus tends to be on larger organizations such as multinational corporations (MNCs), and their visible external accounts rather than informally produced accounts or accounts for internal use. The need for formality in making MNCs accountable is given by the spatial, financial and cultural distance of these organizations

to those who are affecting and affected by its operations (Gray et al. 1996a). Social accounting also questions the reduction of all meaningful information to financial form. Financial data is seen as only one element of the accounting language (Mathews, 2007).

Environmental Accounting on the other hand helps in accurate assessment of costs and benefits of environmental preservation measures of companies (Schaltegger, 2000). It provides a common framework for organizations to identify and account for past, present and future environmental costs to support managerial decision-making, control and public disclosure (KPMG & UNEP, 2006). The severity of environmental problems as a global phenomenon has its adverse impact on the quality of people's life. Measures are being taken both at the national and international level to reduce, prevent and mitigate its impact on social, economic and political spheres (GRI, 2002; GR1, 2006).

Gray et al. (1996a) defined social and environmental reporting as the process of communicating the social and environmental effects of an organization's economic actions to particular interest groups within society and to the society at large. It involves extending the accountability of organizations beyond the traditional role of providing a financial account to the owners of capital, in particular, shareholders. Such an extension is predicated upon the assumption that companies do have wider responsibilities than simply to make money for their shareholders.

The practice of social and environmental accounting and reporting has gained in popularity the world over since it has been treated as an approach that over and above, completes and adds the social to the accounting systems of the organizations. The re-emergence of environmental accounting in the late 1980s and early 1990s brought a notable re-emergence of social accounting practice in the field in the 1990s. Indeed, social accounting and reporting is attracting an almost unprecedented level of interest at the present time (Gray et al., 1997). The Royal Society of Arts in the UK has published an inquiry into tomorrow's company which recommends the development, use and disclosure of social performance indicators (Gray et al. 1997). These and related developments, together with the recent formation of the Institute of Social and

Ethical Accountability (ISEA), have made the technical problems of social accounting practice a matter of some urgency if social accounting practice is to now develop in any systematic way and neither sizzle out through lack of direction nor be captured and trivialized by powerful organizations (Oduol, 2009).

Corporate Social Responsibility (CSR), which social accounting and reporting is part of, is one area that organizations can use to gain competitive advantage over firms that do not practice it (Pricewaterhousecoopers, 2002). Porter et al. (2006) outlined the link between CSR and competitive advantage. Gichana (2004) found that companies quoted on the Nairobi Stock Exchange (NSE) were involved in corporate social responsibility. Society is seen to benefit when organizations implement a social and environmental approach to accounting and reporting in a number of ways; honouring stakeholders' right of information, balancing corporate power with corporate responsibility, increasing transparency of corporate activity, identifying social and environmental costs of economic success (Gray, 2000).

Organizations on the other hand will gain from implementing social accounting practices in the following ways; increased information for decision making, more accurate product or service costing, enhanced image management and public relations, identification of social responsibilities, identification of market development opportunities and maintaining legitimacy. The process of reporting on responsible business performance to stakeholders help in integrating such practices into business practices, as well as identifying future risks and opportunities. Critics of this approach point out that the benign nature of companies is assumed and therefore, responsibility and accountability is largely left in the hands of the organization concerned (Gray, 2000).

This study will be addressing the issues of how firms “do social accounting” that is how firms approach and apply social accounting and reporting and whether by doing so it has an impact on their financial performance. Kenyan firms have not been left behind in the practice of social accounting and reporting. Kenya has observed a spectacular evolution in community and investors stance towards the environment in the past few decades.



Ever-increasing sensitivity of environmental pollution, global warming and diminishing supply of natural resources has attracted direct societal awareness towards the environmental activities of business organizations. This concern about the impact of enterprises on society is a global one. The expectations of consumers, employees, investors, business partners and local communities as to the responsibility of businesses in society are increasing (Kalunda, 2007).

The firms do disclose their social activities in the annual statements though what they report is limited and often reflect only the positives of these activities (Kalunda, 2007). They also use other channels of communicating such as newspapers and the company websites. The study will try to establish the nature and mode of social and environmental accounting and reporting practices amongst the Kenyan firms listed in the Nairobi Stock Exchange and whether by engaging in such practices it has an impact on their financial performance.

### **1.1.2 Financial Performance of Companies**

Blair (1995) suggested five major areas in which a firm's financial performance can be assessed. These areas include liquidity, solvency, profitability, financial efficiency and repayment capacity. The term is used as a general measure of a firm's overall financial health over a given period of time and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Ondieki, 2011).

There are many ways to measure financial performance but all measures should be taken in aggregation. Line items such as revenues from operations, operation income or cash flows from operations can be used as well as total unit sales furthermore the analyst or investor may wish to look deeper into financial statements and seek out margin growth rate or any declining debt (Ondieki, 2011).

### **1.1.3 Relationship between Social and Environmental Accounting and Reporting and Financial Performance**

The current globalized world has witnessed rising social inequalities and the emergence of global environmental problems (Levy et al, 2007). Companies are under intense pressure to take responsibility for their impact on the societies and the environment in which they operate. These has led to companies engaging in CSR activities which in turn leads to Social accounting which attempts to measure the social benefits that an organization provides and the social costs that the organization incurs (Kalunda, 2007).

The empirical study result on the social and environmental accounting and reporting and financial performance link have never been in agreement, as some studies determine negative correlation, some determine positive correlation, while others determined no correlation at all. The viewpoint for positive correlation between social and environmental accounting and reporting and financial performance suggests that a good relationship with employees, suppliers and customers are necessary for the survival of the company. Bowman (1975) pointed out that some shareholders regard CSR as a symbolic management skill, namely, CSR is a symbol of reputation, and the company reputation will be improved by actions to support the community, resulting influence on sale. Therefore, when a company increases its cost by improving CSR in order to increase competitive advantages, such CSR activities can enhance company reputation, thus in the long run financial performance would be improved.

The viewpoint for negative correlation between social and environmental accounting and reporting and financial performance suggests that the fulfillment of the accounting and reporting will bring competitive disadvantages to the company. When carrying out CSR activities, increased cost will result in little gain if measured in economic interest. When neglecting some stakeholders, such as employees or the environment, result in a lower CSR for the enterprise, the financial performance may be improved (Ogolla, 2009).Ullmann (1985) pointed out that here is no reason to anticipate the existence of any

relationship between social and environmental accounting and reporting and financial performance. Arlow et al, (1982) argues that financial performance is not directly linked, either in a positive or negative way to social and environmental accounting and reporting. Whether or not a relationship exists is important to corporate managers. If certain actions reported classified as socially and environmentally responsible tend to be negatively correlated with financial performance of firms then managers may be advised to be cautious in that area. If on the other a positive relationship exists, then management might be encouraged to pursue such activities (Ondieki, 2011).

#### **1.1.4 Nairobi Securities Exchange**

The concern for social costs and the benefits of the business practices have given rise to the need for environmental and social accounting and reporting. The study aims at establishing how companies account and report their positive and negative externalities to the society (Ishmail, 2012) and whether by doing so it has any impact on the firm's financial performance.

The population for this study will constitute listed companies in the Nairobi Securities Exchange as at December 2014. The Nairobi securities exchange was established in 1954. The NSE has been instrumental in enabling the public and private sectors in Kenya to raise large amounts of capital for expansion of new and existing businesses (NSE Handbook, 2013). It thus represents the financial market in Kenya.

The firms listed in the Nairobi Securities Exchange have been reported to participate in corporate social responsibility (CSR) covering varied areas like culture, sports, education, environment and health. They therefore, need to develop effective methods of discharging these responsibilities- social accounting and reporting (Kwalenda, 2007). They are therefore, expected to take a lead in accounting for the huge proportion of shareholders earnings that are put to social actions (social accounting).

The NSE has 64 firms listed on the exchange. The firms are categorised into twelve

sectors which include agriculture, automobiles and accessories, banking, commercial and services, construction and allied, energy and petroleum, insurance, investment, investment services, manufacturing and allied, telecommunication and technology and growth enterprise market segment (GEMS). It deals in ordinary shares and fixed income securities such as preference shares and more recently treasury bonds. The NSE also has some of its shares cross-listed with other stock exchanges in South Africa, Uganda and Tanzania (NSE Handbook, 2013). The NSE requires listed companies to file with them their annual audited reports and to publish them in a paper with a wide circulation.

The registrar of companies regulates companies to operate under Companies Act Cap 486, although there is no regulatory framework that obligates public companies to report social and environmental costs to stakeholders, but only stipulates that companies have to report on their economic issues. ICPAK has also not developed any standards that deal with the measurement and reporting of social responsibilities assumed by individual organizations (Oduol, 2009). The Nairobi Securities Exchange also does not require listed companies to file with them reports relating to social responsibility. Social and environmental accounting and reporting in Kenya is therefore largely voluntary (Ishmail, 2012). NEMA in EMCA (1999) requires starting projects to go through an Environmental Assessment by a NEMA assessor but does not require any more reports after the initial one.

There are various frameworks that are available for reporting on the impact of economic activities on the environment. These include the UNEP environmental framework for Multinational Corporations, The Climate Disclosure Standards Board (CDSB) framework and also the International Integrated Reporting Council (IIRC) has the Integrated Reporting Framework (IR). The IR framework for example divides the capital input for value creation into six Financial, Manufactured, Intellectual, Human, Social and Relational and Natural. The IR framework identifies these categories which are to be used as a guideline to ensure the organization does not overlook a capital that it uses or affects (GRI, 2006). In addition there is the Global Reporting Initiative (GRI) guidelines

called G4 (2013). They are a revision and improvement of the G3 (2008). The Guidelines (G4) assist in the preparation of sustainability reports by organizations, regardless of their size, sector or location (GRI 2013).

## **1.2 Research Problem**

Several studies have been carried out in the area of social and environmental accounting and reporting and its impact on the firm's financial performance. Most organizations are beginning to spend big portions of their earnings on social actions and this is slowly leading them towards accounting and reporting and having an effect on their financial performance (Porter et al., 2006).

Many researchers have since the latter half of 1990s been interested in researching various social and environmental issues. Gray et al (1997) in their paper 'Struggling with the praxis of social accounting', attempted to form a basis for the emergence of social accounting standards. Adams (1999) surveyed UK companies and concluded that corporate and environmental reporting is still, at best, a marginal activity in practice. Gordon (2000) examined the use of accounting to create environmental and social visibilities, and facilitate disclosure and debate. Deegan (2002) considered the desire to legitimize organization operations as one of the many possible motivations for social and environmental reporting (Kalunda, 2007).

According to the concept of business social and environmental accounting, business corporations should incorporate social and environmental accounting information in the annual financial reports to users of financial reports. Furthermore, with the advent of the era of transparency and accountability the demand for social accounting disclosure and reporting is increasingly being of concern and desirable by products of economic activities (Kalunda, 2007). Today, active consumer groups, the public and the government departments demand it and in future, legislations promoted by these groups may make it mandatory.

According to Iyoha (2010), society needs social accounting reports in much the same way that capital markets require financial information supplied by financial accounting systems. Users of social accounting information need the data that allow them to assess whether the entity is being socially, financially and environmentally responsible.

Jerotich (2013) carried out a research to establish the relationship between corporate social responsibility and financial performance of firms in the Manufacturing, Construction and Allied Sector of the Nairobi Securities. One major finding of the study was that there is a strong relationship between the independent variables (CSR practice, efficiency and capital intensity) used in the model and the dependent variable (ROA). Obusubiri (2009) in a study on CSR and portfolio performance also found a positive relationship between CSR and portfolio performance. He attributed this relationship to the good corporate image that comes with CSR making investors prefer such companies implying that good CSR behavior has a reputational benefit for the practicing firm.

However, despite social accounting and reporting being a new phenomenon and the lack of any mandatory regulation towards this disclosure in Kenya, companies are voluntarily engaged in reporting several social responsibility activities in their annual financial reports and it appears that companies have progressed substantially further than literature.

Whereas many studies have been done on CSR in general and on social and environmental accounting and reporting, none has been done to ascertain the effect it has on the firm's financial performance. This study therefore aims to answer the following questions: What areas of social accounting information are reported and in which format are they reported in the annual financial reports of the companies listed in the Nairobi Securities Exchange? What guidelines, if any are followed by the firms in reporting their social and environmental activities? What is the effect of social and environmental accounting and reporting on the performance of firms listed in the NSE as measured by the CSR index and financial performance measured in terms of the Return on assets?

This study aims to bridge the existing gap and will address itself to these questions and

attribute some knowledge of this field of social and environmental accounting to the Kenyan companies' financial reports and hence contribute immensely on its reporting status in Kenya.

### **1.3 Research Objective**

The general objective of this study is to establish the effect of social and environmental accounting and reporting on the financial performance of companies listed on the NSE.

The specific objectives are:

- (i) To identify the areas reported and the format used to report in the annual financial reports of the companies listed in the Nairobi Securities Exchange.
- (ii) To determine whether the companies are following the various frameworks that are available for reporting on the impact of economic activities on the society and environment like the Global Reporting Initiative (GRI) reporting guidelines.
- (iii) To determine whether by accounting and reporting on their social and environmental activities this has an effect on the firm's financial performance as measured by the Return on assets.

### **1.4 Value of the Study**

This study is expected to be of interest particularly to the following:

Company Accountants - They would increase their knowledge on social responsibility accounting and hence meet the challenge to come up with a systematic manner of disclosing such information. Accountants would hence expand their services in the area of social and environmental accounting to their companies.

Stock brokers and Security Analysts - They provide advisory services to investors, this study will be an invaluable source of social information for them in providing investment

advices to socially and environmentally sensitive investors.

The Institute of Certified Public Accountants of Kenya (ICPAK) - Knowledge of issues surrounding social and environmental accounting and reporting is likely to be useful in furthering the interest of ICPAK members in this area. It would contribute immensely to predict the future on the state of social reporting in Kenya and therefore in this regard would guide the standard setters on areas requiring regulations.

Researchers and Scholars- Social and environmental accounting and reporting in Kenya remain a fairly un-researched area. This research is likely to set a pace for more studies in the area of social and environmental accounting the state of the art for Kenyan companies.

The general public will be informed of the various approaches in which an entity can undertake social and environmental activities aimed at improving on the quality of life in the community, workplace, market place and generally giving back to society. This will lead to increased human benefit and satisfaction through quality services and goods.



## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter summarizes the information from existing literature as well as from researchers who have carried out related studies; this includes theoretical as well as empirical (tested) literature relevant to the subject of social and environmental accounting and reporting.

### **2.2 Theoretical Framework**

Theoretical work on social and environmental accounting and reporting has produced a number of theories to explain the motivation of firms to report information on their CSR activities (Gray et al., 1996a). The theoretical framework provides an opportunity towards using corporate social responsibility (CSR) as an instrument in the study of social and environmental accounting and reporting. The theories offer potential in- depth insights to explain the underlying motivations for corporate social and environmental disclosures. All the theories seek to identify and predict the driving factors behind the organizational disclosure decisions (Deegan et al., 2002).

#### **2.2.1 Conceptual Theories for Social and Environmental Accounting**

There are six major ways of theorizing the relationship between an accounting entity and its “outside world”. These theoretical perspectives/ models are conceived of as a series of (overlapping) layers which can be synthesized and built up into a rich conception of the organization- society interaction. These six models are stakeholder theory, legitimacy theory, accountability theory, political economy theory, institutional theory and polyvocal citizenship perspective (PCP) (Gray et al., 1997). The models build up from the harder, more functional organization centred stakeholder perspective, through the slightly softer, society centred accountability, perspective to the softest, stakeholder- centred polyvocal citizenship perspective. The following is a discussion of the four main theories;

### **2.2.1.1 Stakeholder Theory**

Freeman (1984) defines a stakeholder as any group or individual who can affect or is affected by the achievement of the firm's objectives. Stakeholders of the firm include stockholders, creditors, employees, customers, suppliers, public interest groups and governmental bodies. The major objective of the firm is to attain the ability to balance the conflicting demands of the various stakeholders in the firm.

The stakeholder approach to analysis is well established in the management (and accounting) literature (Roberts, 1992). Its essence is the definitions of all those groups or parties who are influenced by and/ or who influence the organization (or accounting entity). From this point on, stakeholder theory struggles to maintain anything other than an organization- centred legitimacy because while the groups may be defined with a fair degree of objectivity, who (other than the organization) is left to define the priorities among the stakeholders and the information that should be disclosed to each one? Stakeholder theory, therefore, is concerned typically with how the organization manages its stakeholders. Thus the information disclosed to the stakeholders may be assumed more properly by the organization to be part of a legitimacy and/or social process.

Stakeholder theory is relatively silent on how the organization does- if at all- monitor and respond to the needs of the stakeholders. It will do so, generally speaking, when it is in the organizations traditional interests (profit- seeking for example) to do so. Francis (1990) has pointed out that accounting as a practice is so much more than mere reporting of the facts. Accounting is a discourse, where the organization chooses what to say, who to say it to, and how to say it. Here, the organization is empowered to highlight, or emphasize certain issues, minimize or eliminate others in the process, affect people's decisions and behaviour. Therefore a social account based on the stakeholder perspective has social value only if we assume the beneficence of the organization and further assume that the stakeholders' needs can be subsumed morally with those of the organization. If we assume this, then "market forces" will generally produce the sort of social accounting

which is in the organization's best interests.

We might reasonably assume that it is this thinking which produces the sort of voluntary social and environmental disclosure we currently see in the annual reports of organizations. Despite its serious limitations, stakeholder theory does help. It defines the influencing/ influenced groups and explicitly defines what accountability the organization itself is willing to recognize and discharge. To deny the organization any role in definition of social account seems inappropriate and largely indefensible (Francis, 1990).

Ullmann (1985) presents a three dimensional model for explaining all correlations among social disclosure and social and economic performance. As indicated above, he presents stakeholder power as the first dimension of the model. He explains this by indicating that the firm will be responsive to the intensity of stakeholder demands. The more critical the stakeholder resources are to the continued viability and success of the corporation, the greater the expectation that the stakeholder demands will be met.

The second dimension is the firm's strategic posture toward corporate social responsibility activities. Strategic posture describes the mode of response of a company's key decision makers concerning social demands. A company whose management tries to influence their organizations status with key stakeholders through social responsibility activities possesses an active posture.

The third dimension concerns the company's past and current economic performance. The importance placed on meeting social responsibility goals may be secondary to meeting the economic demands that impact directly on the company's continued viability. Economic performance directly affects the financial capability to institute social responsibility programs. Therefore, given certain levels of stakeholder power and strategic posture, the better the economic performance of a company, the greater its social responsibility and disclosures.

### **2.2.1.2 Legitimacy Theory**

Legitimacy theory, like a number of other theories such as political economy theory and stakeholder theory, is considered to be a systems- oriented theory. Within a systems-oriented perspective, the entity is assumed to be influenced by, and in turn to have influence upon the society in which it operates (Watts et al., 1986). Corporate disclosure policies and practices are considered to represent one important means by which the management can influence external perceptions about their organizations. The idea of legitimacy can be directly related to the concept of a social contract, consistent with the view that organizations are part of a broader social system, legitimacy theory assumes that organizations are not considered to have any inherent right to resources, or in fact, to exist.

Organizations exist to the extent that the particular society considers that they are legitimate, and if this is the case, the society confers upon the organization the state of legitimacy. Social contract exists between corporations and individual members of society (Mathews, 1993).

Legitimacy theory directly relies upon the concept of “social contract”. Specifically, it is considered that an organization’s survival will be threatened if society perceives that the organization has breached its social contract. Where society is not satisfied that the organization is operating in an acceptable or legitimate manner, the society will effectively revoke the organization’s contract to continue its operations. This might be evidenced through consumers reducing or eliminating demand for the business products of the organization, factor suppliers eliminate the supply of labour and financial capital to the organization, or constituents lobbying the government for increased taxes, fines or laws to prohibit those actions which do not conform to the expectations of the society.

Legitimacy theory would suggest that whenever managers consider that the supply of the particular resource is vital to organization survival, then they will pursue strategies to ensure the continued supply of the resource. Such strategies may include

targeted disclosures, or perhaps, controlling or collaborating with other parties who in themselves are considered to be legitimate (Fiedler et al., 2002).

### **2.2.1.3 Accountability Theory**

Accountability theory is concerned with the relationship between groups, individuals, organizations and the rights to information that such relationships bring about. Accountability is an act of being responsible or answerable for one's own decisions or actions with the expectation of explaining and justifying them when asked to do so. Simply stated, accountability is the duty to provide an account of the actions for which one is held responsible (Gray et al., 1991). The natures of the relationships and the attendant rights to information are contextually determined by the society in which the relationship occurs. It is absolutely true that some sort of relationship will exist between an organization and each of its stakeholders. Part of this relationship may be economic in nature and the terms determined by the parties as reflecting their relative powers in the relationship. The information flowing through the relationship will be determined by the power of the parties to demand it (a power which, where it exists, could arise from either the intrinsic abilities and power of the groups concerned or from the legislative processes of the society) and/or the willingness/desire of the organization to provide it (Gray et al., 1997).

Society as a whole stands expressing a concern that all such relationships and their attendant information rights should not be left entirely to the parties and particularly to the organization. The most noticeable manifestation of this societal concern is statute law and standards established by statutory bodies such as environmental protection agency and health and safety at work inspectorate (Gray et al., 1997). Additionally, other mechanisms such as voluntary codes of practice will from time to time enter the public domain as an agreed or, at least, negotiated part of the stakeholder relationship to which the organization must be accountable for. These empirical, beyond law determinants of accountability have been referred to as quasi-law. The existing formal laws plus the

quasi-laws therefore represent the first and major element in the construction of the organizational obligations and consequently its accountability to the society (Stone, 1975).

It is, of course, naive to assume a simple one-to-one mapping of a society's beliefs about the nature of relationships and the attendant information rights and extant law even with the addition of quasi-law. On the other hand, rights to information must reflect asymmetries of power and essential lags between a society's views and the enactment of law (Dowling et al., 1975). The rights of information can be argued to comprise both positive (legal) and normative (moral) rights. These moral rights must, in some manner, be added to the positive rights to reflect current views of accountability.

#### **2.2.1.4 Political Economy Theory**

Political economy theory explicitly recognizes the power conflicts that exist within society and the various struggles that occur between various groups within the society. The political economy is defined as the social, political and economic framework within which human life takes place (Gray et al., 1996a).

The political economy perspective perceives accounting disclosures as social, political and economic documents (Guthrie et al., 1990). They serve as a tool for constructing, sustaining and legitimizing economic and political arrangements, institutions and ideological themes which contribute to the corporation's private interests. Disclosures have the capacity to transmit social, political and economic meanings for a pluralistic set of report recipients. Political economy theory and legitimacy theory seem to be more appropriate for analysis of existing practices than as normative bases from which to deduce proper accountability relationships.

#### **2.2.2 Classification/Forms of Social and Environmental Accounting**

Forms of social accounting refer to the organization's orientation as far as the practice of social accounting is concerned. According to Dilley (1975) and Wood et al., (2007)

social accounting can be classified into five major categories.

### **2.2.2.1 National Social Income Accounting (Macro Accounting)**

It has existed since 1930s and pursues the measurement of national quality of life on a macro basis. It measures and relates national productivity (in terms of sales) to the social implications that arise due to the factors that increase the Gross National Product (GNP). An increase in GNP would seem to indicate a betterment or progress in the state of affairs of the country. It uses social indicators to show the amount of social progress that has taken place by either the rise or fall of the indicators. They measure social progress in such ways as: national life expectancies, living conditions, levels of diseases, nutritional levels and levels of crime. The main problem with the social indicators approach is that the change in the indicators may not be measured in monetary terms (Wood et al., 2007).

### **2.2.2.2 Social Auditing Approach**

It is mainly at the level of the firm. It attempts to assess entities responsiveness to its social responsibilities over such matters as pollution control minority employment, and employee welfare. This requires applying the concept of control to social responsibility activities by conducting corporate social audit. It can be defined as a review to ensure that an organization gives due consideration to its wider social responsibilities towards those that are directly or indirectly affected by its decisions (Wood et al., 2007).

### **2.2.2.3 Financial/Managerial Social Accounting for Non-profit Entities**

It is similar to social auditing except that performance evaluations are restricted to not-for-profit organizations. Two approaches to measurement are used which include planning, programming, budgeting systems (PPBS) and the social programme measurement. These two are geared towards ascertaining the value for money and thus ensuring money is not wasted. The PPBS enables management to make decisions on a better informed basis on the allocation of scarce resources by reviewing organizational

objectives, identifying programmes to achieve such objectives, identifying and evaluating alternative ways of achieving each objective. The social programme measurement is used for the measurement of governmental projects. This entails performance contracts. The system measures mostly outputs as it is difficult to measure results (Wood et al., 2007).

#### **2.2.2.4 Financial Social Accounting**

Financial social accounting is an extension of the conventional financial accounting. It is primarily concerned with external disclosures by firms in social responsibility areas including human resource asset accounting and compliance with Securities Exchange Commission regulations concerning environmental impact standards. Human resource accounting is considered as an attempt to identify measure and report human investment and activities within an entity. It means accounting for people as the organization resources. It measures the cost and value of the people to the organization. Financial statements of organizations do not include the workforce. The workforce appears in the income statement as a charge against revenues. Financial social accounting seeks to address such issue (Wood et al., 2007).

#### **2.2.2.5 Managerial Social Accounting**

It emphasizes on the development of social responsibility measurements and a reporting system geared to internal decision-making purposes. It advocates for the use of social policies in the management of day-to-day affairs of the organization (Wood et al., 2007).

### **2.2.3 Modes of Disclosures**

Dilley (1973) identified three major approaches towards social and environmental reporting. These reports range from simple, totally subjective, verbal reports to complex reports.



### **2.2.3.1 Descriptive Approach**

This approach is also known as inventory approach. The descriptive report merely lists corporate social activities and is the simplest and least informative. It is easy to prepare and most information discussed is of a qualitative nature rather than of a financial nature. However critics of this method argue that comparability of financial commitments to social and environmental activities over time and across firms is impaired when firms adopt this approach. They further argue that many social descriptive reports are nothing but public relations gestures to ward off grass roots attacks by social activists (Nabhan, 1995).

### **2.2.3.2 Cost of Outlay Approach**

In this approach corporate expenditure is listed on each social activity undertaken. It offers a contrast to the descriptive reports in the sense that the descriptions of activities are quantified. It expands the scope for analyzing the financial commitments to social and environmental activities and verifiability of the amounts recorded relative to the descriptive approach (Nabhan, 1995). The main disadvantage of this approach is that there is no mention of the resulting benefits. This is mainly because corporate expenditure is recorded in terms of cash outlay which is easily determined unlike social benefits that is difficult to measure. (Nabhan,1995).

### **2.2.3.3 Cost Benefit Approach**

It is an extension of cost of outlay approach. It discloses both costs and benefits associated with corporate social responsibility. It is assumed that firms employing this approach make use of shadow prices developed by economists in evaluating the social costs and benefits of proposed projects. The cost benefit approach is the most informative approach (Nabhan, 1995). However, it suffers from difficulties which exist in the measuring of the benefits.

### **2.3.1 Determinants of Corporate Social Responsibility Accounting**

Ogolla (2009) identified the following factors to be key determinants of corporate social responsibility; efficiency, capital intensity and CSR score as the independent variables. Return on Equity measures a firm's efficiency by generating profits from every income of net assets (assets minus liabilities), and shows how well a company uses investment to generate earnings growth. Return on Equity is equal to a fiscal year's net income (after preferred stock dividends but before common stock dividends) divided by total equity (excluding preferred shares), expressed as a percentage. It measures the rate of return on ownership interest (shareholders' equity) of common stock owners.

Capital intensity is shown by how profitable a company is and this is arrived at by the Return on Assets. It is given by the ratio between net income and total assets. This ratio tells us, what the company can do with what it has. It shows the earnings they derive from the assets they control. It is a useful number for comparing competing companies in the same industry. The number will vary widely across different industries. Return on assets gives an indication of the capital intensity of a company, which will depend on the industrial sector. Companies that require large initial investments will generally have lower returns on assets.

### **2.3.2 Determinants of Financial Performance**

The analysis of the determinants of corporate financial performance is essential for all the stakeholders. The Anglo-Saxon corporate governance focuses on maximizing shareholder value. This principle provides a conceptual and operational framework for evaluating business performance. The value of shareholders, defined as market value of a company is dependent on several factors: the current profitability of the company, its risks, and its economic growth essential for future company earnings. All of these are major factors influencing the market value of a company (Ross et al. (1996).

A company's financial performance is measured by its level of profitability. Profitability can be decomposed into its main components: net turnover and net profit margin. Ross et

al. (1996) argues that both can influence the profitability of a company at the same time. A high turnover means better use of assets owned by the company and therefore better efficiency, a higher profit margin means that the entity has substantial market power. Risk and growth are two other important factors influencing a firm's financial performance. Since market value is conditioned by the company's results, the level of risk exposure can cause changes in its market value. Economic growth is another component that helps to achieve a better position on the financial markets, because market value also takes into consideration expected future profits (Ross et al., 1996). The size of the company can have a positive effect on financial performance because larger firms can use this advantage to get some financial benefits in business relations. Total assets are considered to have a positive influence on the company's financial performance, greater assets means less risk. For the companies listed at the stock exchange, its ability to distribute dividends is a proof of stability. For this study return on assets will be used to measure financial performance.

## **2.4 Empirical Studies**

### **2.4.1 Global Studies**

A series of studies carried out have shown that corporate social reporting by companies is increasing (Deegan et al., 1996). Maunders (1982) carried out a survey of published accounts of 300 large companies for the period 1981 to 1982 and concluded that the largest incidence of voluntary disclosure was in the area of human resource. Gray et al. (1995) concluded that for the various categories of social disclosures which included environmental, community and safety the average amount of disclosure had steadily increased from the year 1979 to the year 1991.

Cochran (1984) used the corporate social responsibility rankings to test the relationship between corporate social responsibility activities and a firm's performance. After controlling for industry classification and corporate age, a weak, positive association between social responsibility activities and financial performance was found. Mills

(1984) concluded in his analysis of the relationship between social disclosure and financial performance that companies are more likely to disclose social responsibility expenditures when their financial statements indicate favorable financial performance.

Fauzi (2009) did a research on firms listed on the New York Securities Exchange (NYSE) to determine the relationship between CSR and corporate financial performance. Using a sample of 101 companies listed at the NYSE and a regression model with financial performance as the dependent variable and CSR index as the independent variable, he found that CSR has no effect on financial performance. He however found that leverage (a control variable in the model) has a moderating effect on the interaction between financial performance and CSR.

According to Margolis et al. (2002), one hundred twenty-two published studies between 1971 and 2001 empirically examined the relationship between corporate Social responsibility and financial performance. The first study was published by Narver in 1971. Empirical studies of the relationship between CSR and financial performance comprise essentially two types. The first uses the event study methodology to assess the Short-run financial impact (abnormal returns) when firms engage in either socially responsible or irresponsible acts. The results of these studies have been mixed. The second type of study examines the relationship between some measures of corporate social performance and measures of long term financial performance, by using accounting or financial measures of profitability. The studies that explore the relationship between social responsibility and accounting-based performance measures have also produced mixed results.

#### **2.4.2 Local Studies**

Nabhan (1995) surveyed the social accounting disclosures in published annual financial statements. The population consisted of companies listed at the then Nairobi Stock Exchange (NSE) during the period 1990-1994. The companies were further to be located

in the Nairobi area. This gave a sample of 43 companies which represented about 77 percent of the population. The study relied on both primary and secondary data. Secondary data was obtained from annual financial statements of sample companies over the period 1990 – 1994. The data was then analyzed through data analysis instruments such as the mean, standard deviation and coefficient of variation. The conclusion reached was that all companies in one way or another engaged in one form of social accounting disclosure.

Okeyo (2004) carried out a study on the rationale and factors that determined the levels of corporate social responsibility (CSR) among firms in Kenya. The research was carried out between the years 1997 to 2001 using a questionnaire. A sample of eighty three firms was chosen out of which fifty nine responded. Correlation analysis was used to analyse the data. The research found out that firms in Kenya exhibited high levels of involvement in CSR. This high level of involvement was mainly driven by the use of CSR as a long term strategy. In conclusion average profitability, industry sector and management style were found to be the factors that determined levels of CSR involvement among Kenyan firms.

Oduol (2009) surveyed the social accounting and reporting practices adopted by the mobile phone service providers in Kenya. The population of the study covered four mobile firms that were operating in Kenya by the year 2009. The study used both primary and secondary data. Primary data was collected by way of questionnaires. Content analysis method was used in analyzing the data via statistical package for social sciences. software. He came to a conclusion that all the companies in the mobile phone services industry participated in social responsibility activities and had put in place to systematically channel their contributions to the communities in which they operated. He further observed that what was reported was what would be regarded as good news and that social reporting practices were generally not accounted for separately but were seen just as an extension of the conventional accounting system.

Obusubiri (2009) in a study on CSR and portfolio performance also found a positive

relationship between CSR and portfolio performance. He attributed this relationship to the good corporate image that comes with CSR making investors prefer such companies implying that good CSR behavior has a reputational benefit for the practicing firm.

Jerotich (2013) carried out a research to establish the relationship between corporate social responsibility and financial performance of firms in the Manufacturing, Construction and Allied Sector of the Nairobi Securities. One major finding of the study was that there is a strong relationship between the independent variables (CSR practice, efficiency and capital intensity) used in the model and the dependent variable (ROA).

It can thus be concluded from the findings of the above researches that there is a growing interest in researching about various issues in social and environmental accounting and reporting. In the absence of any guideline or frame work that makes it mandatory to report social and environmental issues it remains dominantly voluntary in nature and the information that is disclosed is mainly positive in nature. Therefore, the researches reviewed give a further understanding of the topic under study and tries to answer the specific objectives of the study.

## **2.5 Summary of Literature Review**

Corporate Social Responsibility reports on a firm's social and environmental performance from a variety of perspectives; including community involvement, employee relations, product safety, philanthropy and the impacts of the firm on the environment. Numerous studies have been conducted based on the belief that a responsible company is rewarded by its good reputation. As a result of this some studies done show positive correlations, others negative and others no correlation at all. From the foregoing summary it emerges that the researchers have not been conclusive as regards to how Kenyan firms listed on the NSE account and report their social and environmental activities in their financial reports. If there are any guidelines they follow when reporting their social and environmental activities and whether social and environmental accounting and reporting

in the annual financial statements has an effect on the financial performance of firms, hence the study aims to bridge this gap.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter presents a description of the procedures that were used to undertake the study. In this regard, the research design which guided the study is identified, described and justified. A description of the population of study and sample size has been offered. The collection method and procedures have been described as well as the data analysis techniques. All the choices made in this chapter were guided by the objectives of the study.

### **3.2 Research Design**

A research design is the structure of research. Newing (2011) states that a research design is a general plan or strategy for conducting a research study to examine specific testable research questions of interest. The study was carried out using a correlational descriptive survey design, employing secondary quantitative data. The descriptive design was considered appropriate for the study because according to Kothari (2003) the survey was concerned with describing, recording, analyzing, and reporting conditions that exist or existed while the correlational studies establishes relationships between various variables.

### **3.3 Population**

A population refers to an entire group of individuals, events or objects having a common observable characteristic (Mugenda et al., 2003). The population for this study constituted listed companies in the Nairobi Securities Exchange as at December 2014. There were 64 companies listed on the Nairobi Securities Exchange. The study employed a census approach; all companies listed on the NSE formed units of study. The selected period under review was a three year period; 2012 to 2014.



### **3.4 Data Collection**

Data collected was both quantitative and qualitative. The study used secondary data. All the data was collected through reviewing of annual reports of the companies, the Nairobi Securities Exchange Handbooks and published books of accounts. The selected period under review was a three year period; 2012 to 2014.

### **3.5 Data Analysis**

Data collected was both quantitative and qualitative in nature. Data collected was then edited, coded and classified into different components to facilitate a better and efficient analysis. CSR reporting has different components and for the purpose of this study, components for environmental concerns, community involvement, employee concerns, product/customer concerns and others were used to analyze social and environmental reporting. Others constituted all those other activities of CSR which could not be attributed to any of the identified categories. Content analysis was used to determine the score for CSR based on the number of sentences dedicated to each component of CSR in the company's annual reports.

Quantitative data was then analyzed using the Statistical Package for Social Scientists (SPSS) 27 tools Version 18.0. The coefficient of determination, R squared, measure was used to test the significance of the regression model in explaining the relationship between CSR practices reported in the annual financial statements and the financial performance. R squared is a measure of goodness of fit showing the percentage variance in the dependent variable that is explained by the independent variable(s). The higher the R squared the better the model. The P-Value and the t-test were used to test the individual significance of the predictor variables that were used in the study. The relationship was explained by the following regression model;

$$ROA_t = \alpha_0 + \alpha_1 CSR_{t-1} + \alpha_2 EFF_{t-1} + \alpha_3 CI_{t-1} + e$$

Where:

ROA= Return on Assets

CSR =Corporate Social Responsibility of firm

EFF=Efficiency

CI=Capital Intensity for firm

e= error term

$\alpha$ =Constant

$\alpha_1$ - a constant (coefficient) of Corporate Social Responsibility

$\alpha_2$ - a constant (coefficient) of Efficiency

$\alpha_3$ - a constant (coefficient) of Capital Intensity

t-1- The previous period

Financial performance was the dependent variable and was measured by Return on Assets, which was calculated as (Net Income/Total assets). Efficiency was the independent variable and calculated as (Cost of sales/Total sales). Capital intensity was also an independent variable and was calculated as (Total assets/Total sales). Capital intensity and efficiency were used as control variables. CSR was obtained by adding the five components; community involvement, employee concerns, staff, product/customer concerns and others. The findings were then presented using tables for easier interpretation.

## **CHAPTER FOUR: DATA ANALYSIS AND FINDINGS**

### **4.1 Introduction**

The purpose of the study was to determine the areas of social and environmental concerns reported and the format used to report in the annual financial reports of the companies listed in the Nairobi Securities Exchange as at January 2012 for consistency of data analysis. It also aimed at determining whether the companies followed the various frameworks that were available for reporting on the impact of their economic activities on the society and environment like the Global Reporting Initiative (GRI) reporting guidelines. It lastly aimed at determining whether by accounting and reporting on their social and environmental activities this had an effect on the firm's financial performance as measured by the Return on assets.

This chapter discusses the data analysis, findings, interpretation and presentation. Content analysis was done through the SPSS after the social and environmental information reported was codified into four themes including environmental concerns, community involvement, employee concerns, product/customer concerns and others and the firm's financial performance measured using Return on Assets and presented using tables. The data for each variable was analysed using correlation and regression analysis tabulated and the finding discussed.

### **4.2 Descriptive Analysis**

This study used content analysis to measure social and environmental accounting disclosures. This method was chosen due to its ability to analyze different types of communication tools including those in written code. Content analysis was used to examine written materials contained in the annual reports. This type of analysis was used due to the fact that this study only focused on one document, which is the annual report. The targeted population for the research was 64 companies. These were the total number of companies listed in the NSE as at December 2014. For consistency of information

required for the research, only 57 companies were analysed. These were the companies that had been listed in the NSE as at January 2011.

#### 4.2.1 Adoption of Social and Environmental Accounting and Reporting

From table 1 it was found that 60% of the companies trading in NSE in 2011 were practicing social and environmental accounting and reporting, 63% in 2012 and 68% in 2013. The trend of adoption of social accounting is above 50% and was improving from 2011 to 2013. This indicates most Kenyan firms are embracing social and environmental accounting and reporting.

Table 1: Companies that have Adopted Social and Environmental Accounting

	2011		2012		2013	
Adopted	Number	Percentage	Number	Percentage	Number	Percentage
Yes	34	60	36	63	39	68
No	23	40	21	37	18	32

#### 4.2.2 Areas of Social and Environmental Accounting Reported

Table 2: Areas of Social and Environmental Accounting Reported

Area Reported	2011	2012	2013
Human Resource	19	23	25
Environment	28	26	25
Consumer Product	19	23	22
Community Involvement	34	28	29

Table 2 shows the areas of social and environmental accounting reported in the annual financial statements across the period 2011-2013. The analysis therefore reveals that disclosure of social and environmental activities is specifically on the discretion of the

companies.

### 4.2.3 Format for Reporting

Table 3: Format for Reporting

	Number	2011(%)	Number	2012(%)	Number	2013(%)
Monetary form	25	74	25	69	27	69
Non- monetary form	9	26	11	31	12	31

Table 3 shows that in 2011 74% of the companies that had adopted social and environmental accounting and reporting reported their social and environment information using monetary form and 26% used a non-monetary format. In 2012 69% used a monetary form while 31% used a non-monetary while in 2013 69% used a monetary format and 31% a non-monetary form. This shows that many companies listed in the NSE still use descriptive form of reporting (non-monetary) on their CSR activities as opposed to financial reports (monetary form).

### 4.2.4 Framework Followed in Reporting

It was observed that the companies did not follow any framework available for reporting on the impact of economic activities on the society and environment like the Global Reporting Initiative (GRI) reporting guidelines.

## 4.3 Regression Analysis and Hypothesis Testing

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
1		B	Std. Error	Beta		
	Constant	0.277	0.544		0.255	0.802
	CSR Score	0.260	0.405	0.193	0.600	0.562
	Efficiency	0.104	0.886	0.048	0.151	0.888
	Capital Intensity	0.399	0.872	0.711	2.033	0.074

From the above, the regression equation was established as follows:

$$Y = 0.277 + 0.260 X_1 + 0.104 X_2 + 0.399X_3$$

From the regression equation it was determined that when the CSR score, efficiency of the firm and capital intensity were zero, financial performance would be 0.277, a unit increase in CSR score would lead to increase in financial performance by a factor of 0.260 while a unit increase in efficiency would lead to increase in financial performance by a factor of 0.104 and a unit increase in capital intensity would lead to increase in financial performance by a factor of 0.399.

#### **4.4 Discussion of Research Findings**

From the findings it was observed that 60% of the companies trading in NSE in 2011 were practicing social and environmental accounting and reporting, 63% in 2012 and 68% in 2013. The trend of adoption of social accounting was improving from 2011 to 2013. This indicates most Kenyan firms were embracing social and environmental accounting and reporting. This indicates there is an ever-increasing sensitivity of social and environmental issues. The expectations of consumers, employees, investors, business partners and local communities as to the responsibility of businesses in society are increasing thereby leading to firms engaging in social responsibility. Due to the huge amount of resources used firms have adopted social and environmental accounting to account for the amounts used both to its shareholders and the society at large.

It was also observed that in 2011 74% of the companies that had adopted social and environmental accounting reported their social and environmental information using a monetary form and 26% used a non-monetary format. In 2012 69% used a monetary form while 31% used a non-monetary while in 2013 69% used a monetary format and 31% a non-monetary form. The monetary format of disclosure was mainly used in the reporting of human resource information and environmental contribution primarily related to retirement benefit, training and development and some community based projects such as adopting school, scholarships and donations. These were activities where the actual cash

out lay used could be measured accurately.

The registrar of companies regulates companies to operate under Companies Act Cap 470, although there is no regulatory framework that obligates public companies to report social and environmental costs to stakeholders, but only stipulates that companies have to report on their economic issues. It was observed that the companies did not follow any framework available for reporting on the impact of their economic activities on the society and environment. The format to follow and the actual information to be disclosed was at the discretion of the companies.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

In this chapter the findings of the study are discussed and conclusions made from which recommendations are submitted. The chapter also highlights the limitations experienced in the course of the study and gives suggestions for further study.

### **5.2 Summary of the Findings**

The general objectives of the study were to identify the areas of social and environmental accounting reported and the format used to report in the annual financial reports of the companies listed in the Nairobi Securities Exchange. The research also aimed at determining whether the companies listed followed the various frameworks that were available for reporting on the impact of their economic activities on the society and environment like the Global Reporting Initiative (GRI) reporting guidelines. Lastly, its aim also was to determine whether by accounting and reporting on their social and environmental activities this had an effect on the firm's financial performance as measured by the Return on assets.

In summary from the analysis, the study established that most of the companies listed in NSE had engaged in one form or another of corporate social responsibility in terms of long term projects such as building schools, scholarship programs, provision of a medical health centre for employees and the community, sponsorship of sports activities, waste management programs and continuous product improvement. This constituted the areas reported in the annual financial statements. All the areas reported grew steadily every year with community involvement leading across all years under review.

As a result of the massive amount of resources put into such activities the companies had adopted social and environmental accounting and reporting to account and report the



usage of such funds. It was found that 60% of the companies trading in NSE in 2011 were practicing social and environmental accounting and reporting, 63% in 2012 and 68% in 2013.

Finally, the study found that monetary form of presentation for reporting was preferred with no actual guideline followed when reporting. In 2011 74% of the companies that had adopted social and environmental accounting and reporting reported their social and environment information using monetary form and 26% used a non-monetary format. In 2012 69% used a monetary form while 31% used a non-monetary while in 2013 69% used a monetary format and 31% a non-monetary form. The study further established through the regression analysis that CSR as measured by the social and environmental accounting and reporting had an effect on the firm's performance as measured by the significantly positive correlation between the CSR score and the financial performance.

### **5.3 Conclusion**

The following conclusions were made following the foregoing discussions above, each corresponding to the specific objectives of the study. This study found out that most Kenyan firms were embracing social and environmental accounting and reporting though they did not follow any guideline when reporting and mostly the report was of a non-monetary form. The study further found that there was a positive relationship between CSR score measuring social and environmental accounting, efficiency and capital intensity with financial performance of companies listed at the Nairobi Securities Exchange for the period under review 2012-2014. The study observed that an increase in the CSR score would lead to increase in financial performance of the companies; the study further revealed that a unit increase in efficiency and capital intensity would further lead to an increase in financial performance of the companies listed in the NSE determined by the information obtained under the years reviewed.

## **5.4 Recommendation**

In respect to the conclusions made in the study, it is evident that social and environmental accounting is on the increase though the reporting is voluntary and there is no set of guidelines followed when reporting. It is definite that corporations by way of conducting their operations create certain problems that directly or indirectly affect the society and the larger natural environment. Therefore regulators such as the NSE, ICPAK and legislators through enactment of laws should develop guidelines and laws to be followed by companies in reporting their social and environmental activities in order to prevent occurrences of such problems.

It is also evident that there is a positive relationship between social and environmental accounting and reporting and a firms financial performance. Top managers must therefore learn to practice social and environmental accounting and reporting. This increases the reputation of their companies and therefore increases their financial performance.

## **5.5 Limitations of the Study**

Despite the findings, various limitations were faced during the study. First the time available for the research constrained the exercise of carrying out the research. More time would have allowed deeper exploration and analysis of the topic under research. Another constraint was a lack of a CSR index to accurately measure the CSR score reported in the financial statements. Therefore the accuracy of the CSR score was questionable. The independent variables chosen for the study were not exhaustive and as such the study encountered a limitation in the explanatory power of the independent variables chosen for the study.

## **5.6 Suggestions for Further Research**

There are a number of areas where future research in this area of research can be undertaken. First the research only took into account listed companies in the NSE. This is a small sample compared to the numerous companies operating in Kenya. Increasing the sample beyond the listed companies to include companies which are not listed in the NSE will allow for a better conclusive conclusion in determining whether indeed social and environmental accounting and reporting has an effect on the firm's financial performance.

The research only took into account 3 years (2012-2014). It will be beneficial to determine whether the conclusions reached would vary significantly or remain the same if the period under review would be extended.

## REFERENCES

- Adams, C.R. (2002). *Ethical reporting: Past and future*. *Management Accounting* February.
- Bebbington, J. & Gray, R.H. (2001). *An account of sustainability: failure, success and a reconceptualisation*. *Critical Perspectives on Accounting* 12 (5), 557-588.
- Cooper, C. (1992). *The non and nom of accounting for (M) other nature*. *Accounting, Auditing & Accountability Journal*, 5 (3), 16-39.
- Cooper, D. R., & Schindler, P. S. (2006). *Business Research Methods, 9th, edition*. McGraw-Hill Publishing, Co. Ltd. New Delhi-India.
- Crowther, D. (2000). *Social and environmental accounting*. London: Financial Times Prentice Hall.
- Davies, N. & L. Okorite.(2007). *Corporate Social Responsibility Accounting: A Wake-Up Call to the Nigerian Accountant*. *Nigerian Accountant*, 40(2), 44-48.
- Deegan, C & Gordon, B. (1996). *A study of the environmental disclosure practices of Australian corporations*. *Accounting and Business Research*, 26 (3), 187
- Deegan, C. (2002). *Financial accounting theory*. Australia, McGraw Hill Australia Pty Ltd.
- Deegan, C., Rankin, M. & Tobin, J. (2002). *An examination of the corporate social and environmental disclosures of BHP from 1983- 1997: A test of legitimacy theory*. *Accounting, Auditing and Accountability Journal*, 15 (3), 312- 343.
- Dowling, J. & Pfeffer, J. (1975). *Organizational legitimacy: Social values and organizational behaviour*. *Pacific Sociological Review*, January: 122-136.

Environmental Management and Coordination Act (Kenya), 1999.

Fauzi, H. (2009). *Corporate Social and Financial performance: Empirical evidence from American companies*. GMJ, 3, Jan – June 2009

Francis, J. (1990). *After Virtue? Accounting as a moral and discursive practice*". *Accounting, Auditing and Accountability Journal*, 3 (5) 17.

Friedman, M. (1970), *The social responsibility of business is to increase its profits*", *NY Times Magazine*, New York, NY, 13 September: 32-33, 122, 124, 126

Freeman, R.E (1984), *Strategic Management: A Stakeholder Approach*, Pitman Publishing, Boston, MA

Gamble, G., Hsu, K. Jackson, C. & Tollerson, C. (1996). *Environmental disclosures in annual reports: An International perspective*. *The International Journal of Accounting*, 31 (3), 293-331.

Global Reporting Initiative (GRI). (2002) *Sustainability Guidelines on Economic, Environmental and Social Performance*. GRI: Boston, MA.

Global Reporting Initiative (GRI). (2006) *Sustainability Reporting Guidelines. Draft Version for Public Comment*, GRI, Amsterdam 2 January 2006-31 March 2006.

Gordon, B. (2000). *Public disclosure and decision making: Exploring possibilities for financial, social and environmental accounting, auditing and accountability* *Journal*, 13 (1), 27-64.

Gray, R., Kouhy, R. & Lavers, S. (1995). *Corporate social and environmental reporting: A review of the literature and a longitudinal study of UK disclosure*. *Accounting, Auditing & Accountability Journal*, 8, 47- 77

- Gray, R. H. (2000). *Current developments and trends in social environmental auditing and attestation*. International Journal of Auditing, 4, 247-268.
- Gray, R. H., Owen, D. L. & Adams, C. (1996a). *Accounting and Accountability: Changes and challenges in corporate social and environmental reporting*, London: Prentice Hall.
- Gray, R., Dey, C., Owen, D., Evans, R & Zadek, S (1997). *Struggling with the praxis of Social accounting*. Accounting, Auditing & Accountability Journal, 10 (3), 325- 364.
- Gray, R., Owen, D. & Maunders, K. (1988). *Corporate Social Reporting: Emerging Trends in Accountability and social contract*". Accounting, Auditing and Accountability and Social contract". Accounting, Auditing and Accountability, 1(6), 20.
- Guthrie, J. & Parker, L. (1990). *Corporate social disclosure practice: A comparative international analysis , advances in public interest accounting*. 3, 159-176.
- Hamilton, C. (1994). *The Mystic Economist*. Canberra: Willow Park Press.
- Henderson, D. (2005), *The role of business in the world today*", Journal of Corporate Citizenship, 17, 30-32.
- Ishmail D. M. & Sira F. N, April 2012, *Social Accounting Practices among Kenyan firms: An empirical study of companies quoted in the Nairobi Stock Exchange*. (April 2012). *Conference Paper Proceedings of 1st JKUAT-SHRD Research Conference* 12th and 13th September 2013.
- Kalunda, E. (2007). *Corporate Social reporting practices: The case of companies listed on the Nairobi Stock Exchange*. Unpublished MBA Project, School of Business, University of Nairobi.
- Kothari, C. (2004). *Research Methodology: Methods & Techniques*, 2nd edition. New age International Publishers, New Delhi, India
- Kwalanda, R. (2007). *Corporate social responsibility at Safaricom limited*.

Unpublished MBA Project, School of Business, University of Nairobi.

Kweyu, M. (1998). *Managerial Attitudes toward Business Social Responsibility: The case of Bank managers in Nairobi*. University of Nairobi, Unpublished MBA Project.

Maunder, K. T. (1982). *Social reporting and the employment report*, in Skerrat, LCT and Tonkin, DJ (eds) *Financial Reporting 1982-83: A survey of UK published accounts*. The institute of Chartered Accountants in England and Wales.

Margolis, J.D. & Walsh, J.P. (2001). *People and profits: The search for a link between a Company's social and financial performance*, Lawrence Erlbaum Associates: Mahwah, NJ.

Mathews, M. (1983). *Socially responsible accounting*. UK: Chapman and Hall

Mathews, M. R. (2007). *Towards a Mega- Theory of accounting in: Gray and Guthrie, Social accounting, Mega accounting and beyond: A fest schrift in honour of Mr. Mathews* CSEAR Publishing.

Mugenda, O. M. & Mugenda, A. G. (2003). *Research Methods: Quantitative and Qualitative Approaches*, Acts Press, Nairobi Kenya

Nabhan, M. Ali (1995). *A survey into social accounting disclosure in published annual financial statements*. Unpublished MBA Project, School of Business, University of Nairobi.

Narang, K. L. & Jain, S.P. (2007). *Advanced Accountancy II* (16<sup>th</sup> edn). New Delhi: Kalyani Publishers.

Newing, H. (2011). *Conducting Research in Conservation: Social Science Methods and Practice*. New York: Routledge  
Ngugi, R. (2005).

Oduol, F. O (2009) *A survey of the social accounting and reporting practices adopted by*

*the mobile service providers in Kenya*. Unpublished MBA project, School of Business, University of Nairobi.

Okeyo, W. O. (2004). *A survey of levels and determinants of CSR among commercial firms in Kenya*. Unpublished MBA project, School of Business, University of Nairobi.

Porter, M E & Krammer, M.R. (2006). *Strategy & Society*. *Harvard Business Review*, 82 (12), 78-92.

Pricewaterhouse coopers(2002). *Value reporting forecast: Bringing information out into the open*. PWC Reports.

Ray, H.G. (1991). *Managerial accounting concepts for planning, control and decision making* (6<sup>th</sup> edn). Boston: Irwin, Inc.

Roberts, B. & Pieter, T. E (1987). *Accounting theory and policy* 2<sup>nd</sup> edn. New York: Harcourt Brace Jovanovich Publishers.

Robson, K. (1991). *On the arenas of accounting change: the process of translation*. *Accounting organizations and society*, 16(5/6), 547-570.

Stone, C. D. (1975). *Where the Law Ends*, New York: Harper & Row.

Ullmann, A., A. (1985). *"Data in search of a theory: A critical examination of the relationships among social performance, social disclosure, and economic performance of U.S. firms."* *Academy of Management Review* 10(3), 540-557.

Wood, F. & Sangster, A. (2007). *Business Accounting 2* (10<sup>th</sup> edn). Harlow, England: Financial Times Prentice Hall, Pearson Education Limited.



## APPENDICES

### Appendix: Secondary Data Collection Sheet

Appendix 1: Secondary Data Collection Sheet					
Number	Company	Period			
		Average (2011-2013)			
		ROA 2014	Capital Intensit y	Efficienc y	CSR
Agricultural Sector					
1	Eaagads Limited	0.0728	2.7864	0.7960	-
2	Kakuzi Limited	0.0964	2.1823	0.8960	-
3	Kapchorua Tea Company Limited	0.3890	0.5801	0.4326	-
4	Limuru Tea Company Limited	3.6787	3.3350	0.2346	-
5	Rea Vipingo Plantations Limited	0.1671	1.0214	0.5326	-
6	Sasini Tea and Cofffee Limited	0.0040	3.3090	0.6652	6
7	Williamson Tea Kenya Limited	0.1421	1.4768	0.0987	-
Automobiles and Accessories					
8	Car and General (Kenya) Limited	0.0570	0.9638	0.8258	-
9	CMC Holdings Limited	0.0084	1.1148	0.8008	-
10	Marshall's (EA) Limited	(0.3623)	1.4960	0.7457	-
11	Sameer Africa Limited	0.0802	1.0276	0.7504	3
Banking					
12	Barclays Bank of Kenya Limited	0.0562	6.8319	0.3476	88
13	CFC Stanbic Bank	0.0272	12.9192	0.1300	18
14	Co-operative Bank of Kenya Diamond Trust Bank (Kenya)	0.0419	9.4216	0.4170	44
15	Limited	0.0375	8.6045	0.4211	58

16	Equity Bank Limited	0.0787	20.7648	0.5684	51
17	Housing Finance Company Limited	0.0132	0.1487	0.5307	22
18	Kenya Commercial Bank Limited	0.0401	0.4318	0.2838	60
19	National Bank of Kenya Limited	0.0132	0.1748	0.5149	22
20	NIC Bank Limited	0.0334	0.2554	0.2911	23
21	Standard Chartered Bank of Kenya Limited	0.0475	0.5869	0.3177	52
	<b>Commercial and Services</b>				
22	Express Kenya Limited	0.2435	1.0249	1.0689	-
23	Kenya Airways Limited	(0.0109)	1.0636	0.5765	45
24	Longhorn Kenya Limited	0.0475	0.7585	0.5547	-
25	Nation Media Group Limited	0.3505	0.6234	0.2239	54
26	Scangroup Limited	0.0945	0.7645	0.5732	-
27	Standard Group Limited	0.0580	0.9161	0.3748	40
28	TPS Eastern Africa Limited (Serena Hotels)	0.0481	2.0976	0.2706	44
29	Uchumi Supermarket Limited	0.0670	0.3735	0.8231	5
	<b>Construction and Allied Sector</b>				
30	ARM Cement Limited	0.0508	2.3223	0.7174	30
31	Bamburi Cement Company Limited	0.1158	1.1165	0.7361	103
32	Crown Paints Kenya Limited	0.0839	0.5518	0.6567	44
33	East African Cables Limited	0.0903	1.3231	0.7080	17
34	East African Portland Cement Company	0.0011	1.5720	0.8757	55
	<b>Energy and Petroleum</b>				
35	Kenol Kobil Limited	(0.0635)	0.2109	0.9588	15
36	Kenya Electricity Generating Company(Kengen)	0.0309	10.9515	0.6601	37

37	The Kenya Power & Lighting Co. Limited	0.0661	1.7101	0.9678	54
38	Total Kenya Limited	0.0400	0.2891	0.8518	60
39	Umeme Limited	0.0981	1.0078	0.6727	-
	<b>Insurance</b>				
40	Britam Limited	0.0640	4.5766	1.0346	12
41	CIC Insurance Limited	0.0799	1.6642	0.8452	13
42	Jubilee Holdings Limited	0.0436	3.4329	0.5948	4
43	Kenya Reinsurance Corporation Limited	0.1213	2.3530	0.7352	1
44	Liberty Kenya Holdings Limited	0.0419	3.9033	0.4065	-
45	Pan Africa Insurance Company Limited	0.0494	2.5143	0.6006	65
	<b>Investment</b>				
46	Centum Investment Company (ICDCI) Limited	0.1198	0.8186	0.7176	15
47	Olympia Capital Holdings Limited	0.0406	0.8200	0.5186	-
48	Transcentury Limited	(0.0024)	1.6197	0.7277	-
	<b>Manufacturing and Allied</b>				
49	Boc Kenya Limited	0.1124	1.8300	0.4809	-
50	British American Tobacco Kenya Limited	0.2489	0.4975	0.3857	57
51	Carbacid Investments Limited	0.3045	2.5058	0.3970	9
52	East African Breweries Limited	0.1672	0.9831	0.5344	88
53	Eveready East Africa Limited	(0.0277)	0.8370	0.0157	-
54	Mumias Sugar Company Limited	(0.0341)	1.8335	0.6832	39
55	Unga Group Limited	0.0392	0.4560	0.9632	23
	<b>Telecommunication and Technology</b>				
56	AccessKenya Group	0.0835	1.2905	0.1897	28

57	Safaricom	0.1369	1.1255	0.4813	40
----	-----------	--------	--------	--------	----