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The Strategic JOURNAL of Business & Change MANAGEMENT
ISSN: 2312-9492 www.strategicjournals.com
Vol. 7, Iss. 4, pp 1191 – 1205 November 17, 2020. www.strategicjournals.com, ©Strategic Journals

INFLUENCE OF DISCLOSURE OF ACCOUNTING AND FINANCIAL REPORTING SYSTEM ON FINANCIAL PERFORMANCE OF SUGAR FACTORIES IN WESTERN KENYA

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Accepted: November 15, 2020

ABSTRACT

This study critically investigated the influence of disclosure of accounting and financial reporting system on financial performance of sugar factories in western Kenya. The study adopted descriptive survey research design and targeted 130 officers from sugar factories in Western Kenya. Sample size was determined using Taro Yamane's proportional sampling technique formula. Primary data was collected by means of self-administered questionnaires then coded, cleaned and analyzed using descriptive and inferential statistics using (SPSS) software. Results were presented using tables for easy readability. Descriptive statistics involved use of percentages. Quantitative data was analyzed using descriptive and inferential statistics. Descriptive analysis summarized data in form of central tendency. Dispersion and inferential analysis was used to test hypotheses. Descriptive analysis included; frequencies, mean, standard deviation and percentages while inferential analysis involved correlation analysis and multiple linear regression analysis. The results revealed that disclosure of accounting and financial reporting systems positively and significantly influence the financial performance of sugar factories in Western Kenya. The study concluded that disclosure of accounting and financial reporting systems have significant influence on financial performance of sugar companies in Western Kenya. Therefore, the study recommended that the sugar companies should disclose information efficiently and timely to their stakeholders thereby improve their financial performance.

Key Words: *Disclosure of Information, Accounting Systems, Financial Reporting System, Financial Performance*

CITATION: Ijami, A., & Miroga, J. (2020). Influence of disclosure of accounting and financial reporting system on financial performance of sugar factories in Western Kenya. *The Strategic Journal of Business & Change Management,* 7 (4), 1191 – 1205.

INTRODUCTION

Fragile financial performance and unstable business environment for sugar factories has led to different studies and reports on ways of improving their performance, with focus on corporate governance. In this perspective, though laws have been made, (Tower, 2018) points out that Good corporate governance and financial performance have a positive relationship.

In Kenya, corruption, financial scandals and collapse of major and big companies has made it possible to re-examine the influence of corporate governance mechanism in organizations (Sentnor, 2017). Capital Market Authority and Private Sector Corporate Governance Trust Kenya has tirelessly been advocating for Good Corporate Governance mechanisms and principles in both small and big organizations.

In the United Kingdom, efforts to improve performance of private and public sector focused on enacting an independent board of directors. Further corporate failures were blamed on breach of corporate governance (Page, 2009). Notably, in USA directors of organizations are not allowed to make decisions freely. Great focus is on Companies Act of the year 2006.

The Kenyan Government through Treasury scrap duty on sweetener from outside regional market which allowed traders to import 1300, 000 tonnes of sugar which is three times the limit the country is required to bring in a year. This plunged the country into crises as sugar unfit for human consumption was smuggled secretly into the country by corrupt cartels. Data by Sugar directorate shows millers are holding 20,000 tonnes of sugar as they are unable to get market. Sugar prices in Kenya are twice as expensive as the average international price. A kilogram of sugar costs sh.60 in Europe, while in Kenya it is sh.120. Kenya has also not met conditions set by COMESA before safeguards are lifted next year. The country has been seeking extension of deadline due by February, year 2019 with little progress in meeting the conditions.

The future of millers in Kenya is not sweet as woes facing sugar industry need a long term solution. Critics have criticized move by some banks to deny access to funds for some ailing sugar factories and have called on government to privatize these loss making companies instead of pumping in tax payers money which is seen as a short term solution. What is puzzling, is how private millers are doing exemplary well while state owned companies are on death bed despite getting financial bailout from government. This short term financial bailout have not worked as most millers continue to wobble in heavy debts with farmers reaping bitter fruits due to millions of shilling they are owed.

The crises of sugar factories in Kenya have gone to the extent of capturing the attention of Presidency. A task force known as Presidential Taskforce on Parastatal reforms was appointed and it is time for its recommendations to be implemented. Tax payers should not continue shouldering the burden of loss making agencies that can thrive if privatized.

Initially, Sugar industry was dominated by the private sector before independence. Large scale production started with establishment of Miwani Sugar Company in 1922 and expanded with the addition of Ramisi Sugar Company in 1927. Kenyan government started playing a role in ownership and management of sugar industry after independence. Five factories were established namely Muhoroni, Chemelil, Mumias, Nzoia and south Nyanza in 1966, 1968, 1973, 1978, 1979 respectively. The latest being West Kenya sugar company. To foster the development and efficient management of sugar industry, the government established Kenya Sugar Authority in 1973, then in 2002 parliament enacted an act to define the roles of the major stakeholders in sugar industry including millers, sugar cane farmers, out grower organizations and Kenya sugar research foundations. Kenya Sugar Board was also created to regulate, develop and promote sugar industry in Kenya.

Beginning in 2012, Mumias Sugar Company began experiencing lowered sugar output and decreased profits, initially blamed on inefficiency. A forensic audit by the audit firm KPMG, found procedural and financial irregularities which top management had hid from the company's board of directors leading to loss of over Kshs 1 billion. This led to firing of 52 top managers. The company asked government for Kshs 2.3 billion in bailout funds of which Kshs 500 million had been advanced as of February 2015. Legal proceedings against the major culprits in the scum have begun.

Sugar sector is one of the most important agricultural sectors in western Kenya. In 1997, it employed 35,000 workers, is a source of income to over 100,000 small scale farmers, and supported over 2 million people. By year 2000, the number of people employed had reduced to 10,552. The status and importance of sugar as a source of livelihood and viable economic concern is under threat from changes and factors in sugar industry such as decline in productivity at farm level and factory level coupled with increased inefficiency. Sugar growing areas are poverty ridden and the bad news is that their source of livelihood which is sugar factories is on collapse trend (Ndemo, 2018). It is time to rethink the path of sugar factories in Western Kenya. Experts have recommended change in business models and have also argued that reforms for sugar industry in its current state may be futile. Despite reforms and efforts such as privatization, diversification and bailout by the government to rescue them, millers in Western Kenya have continued to all. Muhoroni sugar and Mumias Sugar Companies have since closed with Nzoia and Sony Companies staring at similar fate. Dilemma is whether these companies have established Corporate Governance mechanism and whether this has any influence on their financial performance. This study sought to investigate the influence of accounting and financial reporting systems on financial performance of sugar factories in Western Kenya.

Financial performance is the overall financial health of firms as indicated by how well a firm uses its assets to generate income. This can be measured by use of profitability index, return on asset, return on equity, ability to utilize debts and comparison industry performance. This study utilized return on asset and return on equity as indicators of financial performance. The study variables are disclosure, board independence, shareholder rights and Legal and Regularity as the factors affecting the financial performance of sugar factories in Western Kenya. Furthermore Mugenda *et al* (2015), notes that one element can't show all aspects of a firms financial performance which necessitates the use of multiple factors.

Statement of the Problem

Notable sugar factories in Western Kenya have collapsed, while a few are on brink of collapse with many struggling financially. Corporate governance crises continue to haunt majority of sugar factories despite continued tightened regulatory environment from the government including even bailing them out (Wafula, 2018). Though corporate governance is a weighty issue, it is shocking that though few researches have been done, they have failed to link it to financial performance of sugar factories. Further, conflicting findings have been made by different studies on corporate governance with some pointing out that it has no effect on firm's performance while others finding out no existing relationship. Many studies have merely reported on corporate governance. Moreover, Sugar factories continue to face turbulent business environment (Mutai, 2019). Since 1963, Statistics from Kenya Sugar Board indicate that more than 50% of sugar companies have collapsed and the recent collapse of Mumias Sugar, Muhoroni Sugar and Sony Sugar Companies reveals breach of corporate governance principles. The few remaining factories are operating at low capacity (Kenya Sugar Board, 2018).

Different perspectives and ideas have been fronted on how sugar factories should be managed and governed to avoid their collapse. A study by Simala (2016) found that corporate governance negatively affects financial performance. The study recommended another study to longer time period. With Limited existing empirical evidence, this research examined the influence of disclosure of accounting and financial reporting system on financial performance of Sugar factories in Western Kenya.

Objective of the Study

The objective of this study was to investigate the influence of disclosure of accounting and financial reporting system on financial performance of sugar factories in Western Kenya.

The study was guided by the following research hypothesis;

- H_0: Accounting and financial reporting framework does not significantly influence financial performance of Sugar Factories in Western Kenya

LITERATURE REVIEW

Agency Theory

Agency relationship exists whenever one party known as the principal appoints another party known as agent and delegates decision making authority to it. The agent is expected to act on behalf of the principal (Strathmore University, 2009). In regard to this, shareholders are the principals while managers are agents. Managers are expected to act in the best interest of shareholders in order to maximize their wealth but this is not usually the case. Agency problem usually bear agency costs (Orina, 2013). The managers have been entrusted with day to day running of the affairs of the company by their principals who are shareholders. They apply corporate governance principles.

This study applied this theory because corporate governance issues and challenges arise usually from management team and board who are not owners of the companies but mostly experts and professionals expected to make decisions that will grow shareholders wealth. There is agency relationship between shareholders and managers.

Disclosure of Accounting and Financial Reporting Systems:
- Integrity of Accounting and Financial system
- Frequency of Reporting
- Internal Audit Function

→

Financial Performance:
- Profitability
- Dividend Pay-out
- Asset Growth

Independent Variables **Dependent Variables**

Figure 1: Conceptual Framework

Lee (2019) researched on corporate governance and financial reporting in Japan and concluded that high quality laws, codes, guidelines, and institutional arrangements lead to improved corporate governance.

Armstrong (2019) researched on the relationship between financial reporting quality and the level of financial performance on 1,960 international non-financial listed companies from 25 countries and the special administrative region of Hong-Kong for the period 2002-2010 with the results that greater financial reporting quality has positive influence on financial performance. Lin, Jiang Melis (2018) studied on the impact of the quality of financial reporting on performance during the period 2008–2009 in the United Kingdom. The researchers concluded that firms with high-quality financial reporting had better financial performance during the financial crisis. Anicic and Majstorovic (2017) carried out a study on Small Medium Enterprises in Kwazulu, Natal, South Africa on use of international financial reporting standards. The results of the survey revealed that most firms do not follow proper international financial reporting standards. They do, however, use traditional methods in recording their cash collections by using exercise books to keep daily records. The researcher recommended that further research should aim to establish financial management training needs of rural Small Medium Enterprises in Kwazulu to enhance financial performance.

Empirical Review

Velnampy (2015) researched on Financial Reporting System and firm performance for Sri Lankan Manufacturing Companies during the period 2007-2011.The population of the study was 37 manufacturing companies. A sample of 28 companies was used for the study. The independent variables were Board structure, Board size, Board committee, Board meetings, Executive directors, non-independent and non-executive directors. While the dependent variables were Return on Assets and Return on Equity. Both correlation and multiple regression analysis methods were used to analyze data. The findings were that determinants of corporate governance of board structure, Board committee, board meeting, executive directors, independent executive directors and non- executive director and board size were not significant at both 99% and 95% confidence levels to both and ROA and ROE. The findings showed that manufacturing companies do not practice corporate governance guidelines hence the company should pay attention to corporate governance measures. Regression results indicated that all independent values were not significant with values of R squared being low at 0.171 and 0.161 thus the directors should continue playing vital role and advice companies to have more independent directors within the benchmark to the number of directors.

Hendry (2016) researched on accounting and profitability of Nigerian banks. The independent variables were board composition, board size and directors interest. The dependent variable was profitability. The research was for 5years period from 2008 to 2012. Four banks were selected from 22 banks. The findings were that there was positive correlation between corporate governance and profitability. The entire variables were not significant as P value < 0.05. The authors recommended regular review of corporate governance codes hence further research to review the code to be done for longer periods to capture periods of different trade cycles.

Ahmad and Mansur (2012) carried out a study on financial reporting system and Financial Performance of banks in the post Consolidated Era in Nigerian banks. The researcher took a sample of twelve banks during the period 2006-2010. Board size was used as a variable of corporate governance against profitability. There was positive significant relationship between board size and profitability. The twelve banks sampled could not be used as enough sample to conclude on as bearing evidence of corporate governance having impact on profitability.

METHODOLOGY

This research employed descriptive research design. The target population was managers of 6 sugar factories in Western Kenya totaling to 130. This research had managers from sugar factories in Western part of Kenya as sampling frame. Taro

Yamane's proportional sampling technique formula was used to determine sample size. This study utilized stratified sampling technique. This was due to the fact that this technique gave equal chance to all items after they had been divided into subgroups (strata) hence it was not biased. The research applied self-administered questionnaires. Data was collected through use of self-administered questionnaires. Descriptive and inferential statistics were utilized in this study. Statistical packages for social sciences (SPSS) was used to analyze questionnaires.

FINDINGS AND DISCUSSION

Descriptive Analysis of the Variables

This evaluated disclosure of accounting and financial reporting system, institutional share ratio and financial debtor's management and financial performance of Sugar factories in Western Kenya. Five point Likert-type scale from 5=Strongly Agree to 1= Strongly Disagree was employed. Descriptive analysis used percentage, frequency, mean and standard deviation. Mean is a measure of central tendency used to describe the most typical value in a set of values. Standard deviation shows how far the distribution is from the mean.

Disclosure of Accounting and Financial Reporting System

Five statements were formulated to measure disclosure of accounting and reporting system and based on respondents' agreement the results were presented in table 1 as follows;

Table 1: Descriptive, Disclosure of Accounting and Financial Reporting System

Description	SD	D	NI	A	SA	MEAN	SDV
We recognize the independence of transactions in accounting for Receipts and expenditure with effective internal controls	10.39% (9)	22.52% (20)	10.39% (9)	46.57% (37)	11.13% (10)	3.31	1.32
We recognize the distinctiveness of time intervals and frequent of reporting in accounting for receipts and expenditure	8.86% (9)	13.92% (12)	46.84% (38)	24.05% (20)	6.33% (6)	3.16	.987
We exercise full disclosure of material information in accounting of receipts and expenditure We employ professional judgment in making estimates of transactions in accounting of receipts and (7) expenditure	7.59% (9)	18.99% (15)	31.65% (25)	30.38% (24)	11.39% (9)	3.18	1.21
We employ professional judgment in Making estimates of transaction in accounting of receipts and expediture	6.33% (7)	17.72% (15)	36.71% (29)	13.92% (11)	25.32% (20)	3.34	1.31
We remain unbiased and objective in preparation, disclosure and reporting of transactions	3.8% (5)	21.52% (18)	12.66% (10)	32.91% (26)	29.11% (23)	3.62	1.3 2

More than half of the respondents confirmed that they recognize the independence of transactions in accounting for receipts and expenditure with effective internal controls of which 46.57 % (37) agreed and further 11.13 %(10) strongly agree. With a mean of 3.3152 and standard deviation of 1.32653, the results indicated that there was great dispersion from undecided (Mean=3). However, 10.39% (9) and 22.52% (20) of the respondents strongly disagreed and disagreed respectively.

On distinctiveness of time intervals and frequent of reporting in accounting for receipts and expenditure, majority of the respondents were not sure as shown by 46.84%(38) of the respondents. However, only 30.38% of the respondents were in agreement. Mean of 3.16 and standard deviation of .9870 revealed there was dispersion from the undecided (Mean=3).

Further, the results revealed 30.38% (24) of the respondents agreed and 11.39% (9) strongly agreed that they exercise full disclosure of material information in accounting of receipts and expenditure while 31.65% (25) were undecided. A mean of 3.1899 and standard deviation of 1.21028 indicated that there was great dispersion from the undecided (mean=3)

On use of professional judgment in making estimates of transactions in accounting of receipts and expenditure, 36.71 % (29) of the respondents were undecided while 13.92 % (11) agreed and further 25.32 % (20) strongly agreed. With a mean of 3.3418 and standard deviation of 1.21830, there was great dispersion from the undecided (Mean=3).

Finally, on half of the respondents confirmed that they remain unbiased and objective in preparation, disclosure and reporting of financial transactions with 32.91% (26) agreeing and additional 29.11% (23) strongly agree. A mean of 3.6203 and standard deviation of 1.32269 imply that there was great dispersion from agree (mean=4)

Financial Performance

To measure financial performance of Sugar factories in Western Kenya, a set of six statements were formulated. The respondents were asked to indicate the extent of agreement with each of the financial performance statements. The pertinent results are presented in Table 2.

Table 2: Descriptive for Financial performance

	SD	D	NI	A	SA	Mean	SDV
My organization profit have increased for the last five years	3.8% (3)	17.72% (14)	22.78% (18)	21.52% (17)	34.18% (27)	3.6456	1.23036
My organization salary for the employees have improved in the recent years	2.53% (2)	18.99% (15)	20.25% (16)	35.44% (28)	22.78% (18)	3.5696	1.11727
My organization have grown in size in terms of the assets	2.53% (2)	13.92% (11)	17.72% (14)	48.1% (38)	17.72% (14)	3.6456	1.01322
My organization capital base has increased from previous years	3.8% (3)	10.13% (8)	11.39% (9)	59.49% (47)	15.19% (12)	3.7215	0.97319
My organization has increased the number of employees in the recent past.	7.59% (6)	8.86% (7)	7.59% (6)	51.9% (41)	24.05% (19)	3.7595	1.14595
My organization dividend payout has increased for the last five years.	3.8% (3)	22.78% (18)	24.05% (19)	41.77% (33)	7.59% (6)	3.2658	1.02167

The findings revealed that more than half of the respondents confirmed that their organization profit has increased for the last five years of which 21.52% (17) agreed and additional 34.18% (27) strongly agree. A mean of 3.6456 and standard deviation of 1.23036 implies that there is great dispersion from agree (mean=4). It was also revealed that more than half of the respondents confirmed that their organization salary for the employees has improved in the recent years of which 35.44% (28) agree and additional 22.78% (18) strongly agree. A mean of 3.5696 and standard deviation of1.11727 implies that there is great dispersion from agree (Mean=4).

On organization size in terms of the assets, 48.1% (38) of the respondents agreed and additional 17.72% (14) strongly agree with a mean of 3.6456 and standard deviation of 1.01322. This implies that there was dispersion from agree (mean=4). The results also revealed that organization capital base has increased from previous years as indicated by 59.49 % (47) of the respondents who agreed and 15.19% (12) who strongly agree. A mean of 3.7215 and standard deviation of 0.97319 implies there is dispersion from the mean.

Regarding the increase in the number of employees in the recent past, 51.9% (41) agreed and 24.05 %(19) strongly agree with a mean of 3.7595 and standard deviation of 1.14595. This implies that there is great dispersion from agree. Lastly, less than half of the respondents confirmed that organization dividend pay-out has increased for the last five years of which 41.77% (33) agreed and 7.59% (6) strongly agree with a mean of 3.2658 and standard deviation of 1.02167. This implies that there is great dispersion from the undecided (mean=3).

Inferential Statistics

This section presents the results of correlation analysis where the relationships between the dependent variable thus the financial performance, the independent variables represented by the corporate governance including disclosure of accounting and financial reporting system, institutional share ratio and financial debtors management and moderating variable which was presented by government policies and regulations is presented. The results of simple linear regression were also done for each variable then multiple regressions were done for study regression model.

Disclosure of Accounting and Financial Reporting System

Disclosure of Accounting and Financial Reporting System was operationalized as Integrity of Accounting and financial system, frequency of reporting and internal audit function while financial performance was measured using profitability, dividend pay-out and asset growth. The findings of this objective answered the first research question which sought to find out the influence of disclosure of accounting and financial reporting system on financial performance of Sugar factories in Western Kenya.

Correlation Analysis for Disclosure of Accounting and Financial Reporting System

The Pearson correlation analysis was used to investigate the relationship between disclosure of accounting and financial reporting system and financial performance. The results are as shown in are Table 3.

The Strategic Journal of Business & Change Management. **ISSN** 2312-9492 (Online) 2414-8970 (Print). www.strategicjournals.com

Table 3: Correlation Results for Disclosure of Accounting and Financial Reporting System

		Disclosure of Accounting and Financial Reporting	Financial Performance
Disclosure of Accounting and Financial	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	79	
Financial Performance	Pearson Correlation	.567**	1
	Sig. (2-tailed)	.000	
	N	79	79

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

In determining the effect of Disclosure of Accounting and Financial Reporting System on financial performance of Sugar factories in Western Kenya, the study established a coefficient of correlation (r) as 0.567**. The objective answered what is the influence of Disclosure of Accounting and Financial Reporting System on financial performance of Sugar factories in Western Kenya as per the first research question of the study. This implied that the financial performance increases with increase in disclosure of accounting and Financial Reporting System and decrease in disclosure of accounting and financial reporting system leads to decrease in financial performance. The results indicated that the relationship between Disclosure of Accounting and Financial Reporting System and financial performance is positive, moderate and significant.

Regression Results of Disclosure of Accounting and Financial Reporting System

Regression analysis was used to tell the amount of variance accounted for by one variable in predicting another variable. Regression analysis was conducted to find the proportion in the dependent variable (financial performance) which can be predicted from the independent variable (Disclosure of Accounting and Financial Reporting System). Table 4 showed the analysis results.

Table 4: Regression Results of Disclosure of Accounting and Financial Reporting System

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.567[a]	.321	.312	.7251

ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	19.143	1	19.143	56.403	.000[a]
	Residual	40.491	77	.526		
	Total	59.634	78			

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The results revealed a coefficient of determination (r^2) of 0.312. Meaning Disclosure of Accounting and Financial Reporting System can explain 31.2 % of the variance in financial performance of Sugar factories in Western Kenya. The adjusted r square attempts to produce a more honest value to estimate r square for the population. The F test gave a value of $F(1, 77) = 56.403$, $P<0.01$, which was large enough to support the goodness of fit of the model in explaining the variation in the dependent variable .It also means Disclosure of Accounting and Financial Reporting System is a useful predictor of financial performance.

The regression equation for Disclosure of Accounting and Financial Reporting System becomes:

Y = 1.892 + 0.521DAF

From the regression equation it means that when Disclosure of Accounting and Financial Reporting System increase by 0.521 %, financial performance will change by 1% in the same direction. This result is similar to correlation findings where Disclosure of Accounting and Financial Reporting System is positively correlated to performance. These finding agrees with Waleed (2014) who found out that disclosure was significantly and positive related with financial performance. Similar results were obtained with Wanjiku (2016) who found out that disclosure of information significantly correlated with return on assets. Matama's (2008) results that transparency and disclosure played a huge role in the corporation's financial performance as stakeholders tend to invest in entities that they trust with regards to their CG practices. Ayorinde et al. (2012) the corporate governance disclosure index is positively correlated at 0.775 with financial performance. This further indicates that Sugar factories that disclose more on corporate governance issues are likely to perform better than those that disclose less.

However, the findings contradicts Kutto (2016) found a negative weak correlation between disclosure of information and financial performance of the regional development authorities in Kenya. The negative correlation between disclosure of information and financial performance is explained by the fact that investors may view disclosure of more information as an attempt by management of unlisted commercial Sugar factories to try and impress them in order for them to buy shares of the commercial bank.

CONCLUSIONS AND RECOMMENDATIONS

Regarding influence of disclosure of accounting and financial reporting system on financial performance of Sugar factories in Western Kenya, more than half of the respondents recognized the independence of transactions in accounting for receipts and expenditure, adequate internal controls, unbiased preparation, disclosure and reporting of financial transactions. This study found that disclosure of accounting and financial reporting system has a positive and significant correlation with financial performance of Sugar factories in Western Kenya. This implies that an increase in disclosure of accounting and financial reporting causes rise in financial performance.

Similarly, Mazur and Banham (2018) found that financial performance result from corporate governance practices. This is in line with agency theory. Results from disclosure of accounting and financial reporting system shows credibility in preparation, disclosure and reporting of financial information has boosted confidence of users.

Conclusion is that Disclosure of accounting financial reporting system is positive and significant on financial performance of Sugar factories in Western Kenya this means that when firm increases their disclosure of accounting and financial reporting, their financial performance rise greatly. Sugar factories should be unbiased and objective in preparation, disclosure and reporting of financial transactions and they exercise full disclosure of material information in accounting of receipts and expenditure to boost confidence of shareholders.

The study therefore recommends that sugar factories in Western Kenya should disclose information efficiently and timely to their stakeholders so as to boost credibility and result to their financial performance.

Areas for Further Studies

This research studied influence of corporate governance on financial performance of sugar factories in Western Kenya. Further research in other areas not covered should be done. Therefore, further studies should be conducted to find out the role of government policies and regulation on disclosure of accounting and financial reporting system. Another study should also be done using secondary data and based on data on Corporate governance and financial performance on listed companies.

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