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THE EFFECT OF MATERIALITY PRINCIPLE ADOPTION ON FINANCIAL ACCOUNTABILITY OF STATE CORPORATIONS IN NAKURU CITY, KENYA

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Abstract:
State corporations play a crucial role in Kenya's socioeconomic development. To fulfill their mandates and deliver value to taxpayers, these entities must uphold strong financial accountability. The State Corporations Act of 2012 outlines several key requirements to ensure financial accountability. State corporations face many accountability challenges when presenting financial statements. Accounting standards aim to improve the quality and comparability of financial reporting in the public sector. This study looks at the effect of materiality principle adoption on the financial accountability of state corporations in Nakuru City. This study adopted a quantitative, cross-sectional research design grounded in agency theory and financial accounting theory. The target population comprised senior administrative and finance/accounting staff from 12 selected state corporations in Nakuru City. A structured questionnaire was administered to a sample of 58 individuals from these corporations. A correlation was found between the materiality principle adoption and financial accountability. A linear regression analysis was conducted to examine the extent of the relationship between the materiality principle adoption and financial accountability. Respondents generally disagreed that financial statements always lack misstatements, indicating recognition of potential errors. Based on the evidence from the correlation analysis, linear regression, and ANOVA, the null

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hypothesis (H_0) was rejected. This indicates a statistically significant relationship between the materiality principle adoption and financial accountability in state corporations in Nakuru City. Adhering to the materiality principle can have a positive impact on improving financial accountability within these organizations.

JEL: H83, M41, D73, C12

Keywords: materiality principle, financial accountability, state corporations

1. Introduction

State corporations play a vital role in socio-economic development by implementing government policies and providing services. They rely on public funds, making financial accountability essential. Financial accountability refers to the responsible management and transparent reporting of financial resources, which are critical to public trust and effective governance. Despite its importance, many state corporations face challenges, including incomplete financial information, non-compliance with financial regulations, and adverse audit opinions (Azzali *et al.*, 2018).

Accounting principles such as the materiality principle significantly impact financial accountability. The materiality principle ensures that all significant financial information is included in reports, preventing omissions or misstatements that could affect decision-making. Therefore, the materiality principle ensures that financial statements reflect all essential information that could influence decisions (Obilor & Yitonierani, 2019). The principle's adoption has become increasingly crucial as public sector organizations face growing scrutiny over their financial management practices and accountability.

Globally, financial accountability is a common issue. In countries like South Africa, Nigeria, and Ghana, public entities struggle with mismanagement, audit failures, and financial irregularities (Dennis & Ogoun, 2018). In Kenya, the State Corporations Act mandates mechanisms for financial accountability, including proper record-keeping, audits, and reporting. However, Kenyan state corporations, such as the National Cereals and Produce Board and Naivasha Water Sewerage and Sanitation Company, have faced challenges in adhering to these standards. These challenges highlight the need for robust accounting principles and practices to enhance financial accountability.

2. Specific Objectives

To determine the effect of materiality principle of accounting on the financial accountability of state corporations in Nakuru city.

2.1 Research Hypothesis

H02: There is no statistically significant effect of the adoption of materiality principle of accounting on the financial accountability of state corporations in Nakuru city.

3. Theoretical Framework

3.1 Agency Theory

Agency Theory provides a framework for understanding the relationship between principals (taxpayers) and agents (state corporations) in the context of public sector organizations. This theory highlights the potential conflicts of interest that can arise when agents have the authority to make decisions on behalf of principals. Information asymmetry, where agents have more information than principals, can create opportunities for moral hazard. Agents may prioritize their own interests over those of the principals, leading to misuse of public funds. The materiality principle is crucial in ensuring financial accountability in state corporations (Frank, 2019). By requiring supporting documentation for all financial transactions, the materiality principle helps to reduce information asymmetry, prevent moral hazard, and enhance transparency, allowing stakeholders to understand the use of public funds better (Elkhashen & Ntim, 2018).

3.2 The Financial Accounting Theory

The financial accounting theory is thought to focus on the why of accounting and was developed by scholar William R. Scott. It checks on why things are the way they are within the accounting content. Amongst the aspects that drive the accounting principles include uncertainty and information asymmetry, supply and demand of accounting information, and the purpose of financial reporting (Elkhashen & Ntim, 2018). The uncertainty and information asymmetry relate to the differences in the information held by the financial information recorders and the financial decision users. The elimination of the information asymmetry effects, such as moral hazards and adverse selection challenges, ensures that financial decision-makers' improper utilization of financial information as a result of the pursuit of self-interest by the financial decision makers is mitigated (Yulistyawati *et al.*, 2019). The supply and demand of financial information are critical in the manner in which financial information is developed. The suppliers of the financial information include accountants, while the demand for the financial information is based on financial decision makers. The purpose of financial accounting for explanatory purposes influences how it is prepared. This theory is essential in this study because it examines the different components of the accounting information on financial performance. Thus, the theory is useful in determining the influence of accounting principles on aspects of financial accountability.

4. Methodology

This study employed a quantitative, cross-sectional research design to identify relationships between variables and make predictions about future outcomes based on these correlations. This approach was particularly suitable for exploring how adherence to specific materiality accounting principles influences financial accountability in public corporations. The research design enabled systematic examination of relationships between variables while maintaining objectivity and generalizability of findings.

The target population comprised 58 individuals, including finance staff and senior administrators from 10 state corporations in Nakuru City, Kenya. These corporations were selected using purposive sampling to represent larger organizations, avoiding bias. The sample size was determined to be sufficient for effective generalization of findings. Data collection utilized structured questionnaires containing both categorical questions and Likert-based scales designed to measure respondents' views on accounting principles and financial accountability.

To ensure research quality, a pilot study was conducted on 6 members to test the questionnaire's validity and reliability. Content validity was established through expert review, while reliability was measured using the Cronbach alpha coefficient, with a threshold of 0.7 indicating sufficient reliability. Data analysis employed regression analysis using IBM SPSS software, with ANOVA tests checking for associations between independent and dependent variables at a 5% significance level. Ethical considerations were prioritized throughout the study, ensuring anonymity, confidentiality, and informed consent for all participants.

5. Results and Discussion

5.1 Descriptive Statistics for Materiality Principle Adoption

The study examined respondents' perceptions regarding materiality principle adoption in state corporations using a five-point Likert scale ranging from Not At All (1) to Very Large Extent (5). The responses provide insights into the current state of materiality principle implementation and its relationship with financial accountability in these organizations. Table 1 presents the distribution of responses across various aspects of materiality principle adoption.

Table 1: Rating of Agreement with Materiality Principle Statements

Statement	Not at All	Small Extent	Moderate Extent	Large Extent	Very Large Extent
Financial statements lack misstatements	34.48%	25.86%	17.24%	13.79%	5.17%
Misstatements are dealt with conclusively	31.03%	24.14%	20.69%	13.79%	6.90%
Material decision-making info included	37.93%	27.59%	17.24%	10.34%	6.90%
Misstatements due to mistakes vs fraud	25.86%	24.14%	20.69%	17.24%	12.07%
Transactions have supporting documents	27.59%	24.14%	20.69%	17.24%	10.34%

Note: N = 58

The analysis of materiality principle adoption reveals significant patterns in financial reporting practices within state corporations. A substantial majority (34.48%) of respondents strongly disagreed with the statement that financial statements lack misstatements, indicating widespread recognition of reporting challenges. This finding aligns with previous research by Azzali *et al.* (2018) and Mohs (2017), who identified persistent challenges in maintaining error-free financial statements in public sector organizations. The high percentage of respondents acknowledging potential misstatements suggests a need for enhanced control mechanisms and more rigorous application of materiality principles.

Regarding handling identified misstatements, 31.03% of respondents indicated that their organizations do not conclusively address such issues. This finding corresponds with Dennis and Ogoun's (2018) observations about public sector organizations' challenges in implementing effective error correction mechanisms. The data suggests a gap between the identification of misstatements and their resolution, potentially impacting the overall quality of financial reporting and accountability. Furthermore, the relatively low percentage of respondents (6.90%) who indicated a very large extent of implementation of corrective measures highlights the need for more robust remediation processes.

5.2 Correlation Analysis

This section examines the relationship between materiality principle adoption and financial accountability through correlation analysis. The analysis aims to establish the strength and direction of the relationship between these variables before proceeding with a more detailed regression analysis.

Table 2: Correlation between Materiality Principle Adoption and Financial Accountability

Variable	1	2
1. Financial Accountability	1.00	.429**
2. Materiality Principle Adoption	.429**	1.00

Note: ** Correlation is significant at $p < .01$ level (2-tailed). N = 90

The correlation analysis revealed a significant positive relationship between materiality principle adoption and financial accountability ($r = .429$, $p < .01$). According to Cohen's (1988) interpretation criteria, correlation coefficients between .30 and .49 indicate a moderate relationship between variables. The observed correlation coefficient of .429 demonstrates a moderate positive relationship, suggesting that increased adherence to materiality principles is associated with improved financial accountability in state corporations. This finding aligns with the theoretical framework of agency theory, as proper implementation of materiality principles helps reduce information asymmetry between principals (taxpayers) and agents (state corporations) (Frank, 2019; Elkhashen & Ntim, 2018).

5.3 Regression Analysis

To determine the effect of the materiality principle adoption on financial accountability, a comprehensive regression analysis was conducted. This analysis examines the predictive relationship between the independent variable (materiality principle adoption) and the dependent variable (financial accountability).

Table 3: Model Summary of Materiality Principle Adoption Effect on Financial Accountability

Model	R	R^2	Adjusted R^2	SE
1	.429	.284	.274	0.51333

Note: SE = Standard Error of the Estimate.

The regression model's R-value of .429 indicates the strength of the relationship between materiality principle adoption and financial accountability. According to Hair *et al.* (2019), R represents the correlation between the observed and predicted values of the dependent variable. The achieved R-value suggests a moderate positive relationship between the variables. The R^2 value of .284 indicates that materiality principle adoption explains 28.4% of the variance in financial accountability. This finding aligns with research by Christensen *et al.* (2018) and Al-Halabi (2017), who found that materiality principles significantly influence financial accountability outcomes in public sector organizations.

Table 4: ANOVA Results for Regression Model

Source	SS	df	MS	F	p
Regression	5.220	1	5.220	19.810	.000
Residual	22.189	88	.264		
Total	28.409	89			

Note: SS = Sum of Squares; MS = Mean Square

The ANOVA results demonstrate the statistical significance of the regression model, $F(1, 88) = 19.810$, $p < .001$. Field (2018) states that the F-test assesses whether the regression model predicts the dependent variable significantly. The achieved p-value of less than .001 indicates that the model is highly significant, suggesting that materiality principle adoption is a reliable predictor of financial accountability. This finding supports previous research by Komang *et al.* (2019) and Mohs (2017), who identified significant relationships between materiality principles and financial accountability measures in public institutions.

Table 5: Regression Coefficients

Variable	B	SE	β	t	p
Constant	2.756	.398		6.931	.000
Materiality Principle Adoption	.401	.090	.429	4.451	.000

Note: B = unstandardized coefficient; SE = standard error; β = standardized coefficient

The regression coefficients presented in Table 5 provide critical insights into the relationship between materiality principle adoption and financial accountability. The analysis reveals a significant positive effect of materiality principle adoption ($\beta = .429$, $t = 4.451$, $p < .001$) on financial accountability. According to Hair *et al.* (2019), regression coefficients with p-values less than .05 indicate statistically significant relationships between variables. The unstandardized coefficient ($B = .401$) suggests that for each unit increase in materiality principle adoption, financial accountability increases by 0.401 units, holding other factors constant. This finding demonstrates the substantial impact that materiality principles have on improving financial accountability in state corporations.

The significant positive relationship aligns with agency theory's predictions about the role of materiality principles in reducing information asymmetry between stakeholders. As noted by Frank (2019) and supported by Elkhashen and Ntim (2018), proper implementation of materiality principles helps bridge the information gap between principals (taxpayers) and agents (state corporations). The standardized coefficient ($\beta = .429$) indicates a moderate effect size, suggesting that while materiality principle adoption significantly influences financial accountability, other factors also contribute to the overall accountability framework in state corporations. This finding corresponds with research by Azzali *et al.* (2018) and Christensen *et al.* (2018), who identified multiple factors affecting financial accountability in public sector organizations.

5.4 Hypothesis Testing

Table 6: Summary of Hypothesis Testing Results

Hypothesis	Test Statistic	p-value	Decision
H_{02}: There is no statistically significant effect of adoption of materiality principle of accounting on financial accountability	t = 4.451	.000	Reject H_{02}

Note: Decision criterion: Reject H_0 if $p < .05$.

Based on the hypothesis testing results, the null hypothesis (H_{02}) was rejected ($t = 4.451$, $p < .001$). According to established statistical conventions (Field, 2018), a p-value less than .05 provides sufficient evidence to reject the null hypothesis. The rejection of H_{02} indicates that materiality principle adoption has a statistically significant effect on financial accountability in state corporations. This finding supports the theoretical framework underpinning the study. It aligns with previous research by Dennis and Ogoun (2018) and Mohs (2017), who found significant relationships between materiality principles and financial accountability measures in public sector organizations.

6. Discussion

The findings of this study highlight the materiality principle of accounting adoption with regard to financial accountability. A majority of respondents disagreed that financial statements lacked accuracy (Not at All: 34.48%) and emphasized the importance of consistency in financial information presentation (Large Extent: 39.66%). This potential inconsistency might warrant further investigation to understand the underlying reasons. Perhaps respondents differentiate between the concept of materiality and the actual application within state corporations. The correlation does not necessarily imply that applying the Materiality Principle causes better financial accountability. Corporations with financial solid accountability may also be more likely to follow the Materiality Principle. The results of the hypothesis testing provide clear evidence of the relationship between adopting the materiality principle of accounting and financial accountability in state corporations in Nakuru City. The Pearson correlation coefficient ($r = 0.429$, $p = 0.000$) indicates a strong positive relationship between these variables, demonstrating that increased adherence to the materiality principle correlates with improved financial accountability. This suggests that state corporations that apply the materiality principle more rigorously tend to exhibit higher levels of financial transparency and accountability. Further supporting this finding, the linear regression analysis shows that the materiality principle can explain 16.4% of the variation in financial accountability (R-squared = 0.284). Although this value does not explain all the variability in financial accountability, it highlights the significant contribution of the materiality principle in shaping financial management practices within these organizations.

The ANOVA results ($p = 0.000$) reaffirm the significance of the relationship between the two variables, and the coefficient analysis (0.401) suggests a positive, direct effect. Specifically, a one-unit increase in adherence to the materiality principle results in a 0.401-unit increase in financial accountability. This further emphasizes the materiality principle's critical role in promoting sound financial practices, reducing misstatements, and ensuring reliable financial reporting.

7. Conclusion

The results of this study clearly reject the null hypothesis (H_{02}), affirming that adopting the materiality principle of accounting has a statistically significant impact on financial accountability in Nakuru City's state corporations. The positive correlation, robust regression outcomes, and significant ANOVA findings underscore the critical role of materiality in ensuring accurate and transparent financial reporting. By consistently applying this principle, state corporations can enhance accountability, mitigate financial mismanagement, and build trust with stakeholders. These findings advocate for greater integration of materiality in accounting practices as a cornerstone of effective financial governance, which is pivotal for promoting transparency, preventing fraud, and fostering sustainable public financial management.

8. Recommendations

Based on the study's findings, several key recommendations emerge to enhance financial accountability in state corporations in Nakuru City:

1) **Strengthen Training and Implementation:** Develop and implement targeted training programs for accounting professionals and financial managers in state corporations. These programs should focus on the practical application of the materiality principle, ensuring consistency in financial information presentation and fostering a deeper understanding of its impact on financial accountability.
2) **Conduct Further Investigations:** Initiate qualitative research to explore the underlying reasons for the observed discrepancies in materiality application. This will help identify potential barriers to consistent implementation and areas where additional support or clarification is needed.
3) **Benchmarking and Best Practices:** Establish a framework for benchmarking and sharing best practices related to the materiality principle across state corporations. This could include creating a repository of case studies and success stories highlighting effective applications and their benefits in enhancing financial accountability.
4) **Regular Monitoring and Evaluation:** Implement a system for regular monitoring and evaluation of materiality principle adherence. This system should include periodic reviews and audits to assess the effectiveness of materiality application and its impact on financial transparency and accountability.
5) **Policy Recommendations:** Advocate for the integration of materiality principles into financial reporting standards and regulations at the policy level. Ensuring that these principles are embedded in regulatory frameworks will support uniform application and reinforce their importance in financial governance. By addressing these recommendations, state corporations can enhance their financial management practices, improve transparency, and foster greater trust among stakeholders.

Conflict of Interest Statement

The authors declare no conflicts of interest.

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