

**EFFECT OF AUDIT COMMITTEE
CHARACTERISTICS ON QUALITY OF FINANCIAL
REPORTING AMONG NON-COMMERCIAL STATE
CORPORATIONS IN KENYA**

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(Accounting)

**JOMO KENYATTA UNIVERSITY OF
AGRICULTURE AND TECHNOLOGY**

2018

**Effect of Audit Committee Characteristics on Quality of Financial
Reporting among Non-Commercial State Corporations in Kenya**

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**A Thesis Submitted in Partial Fulfilment for the Degree of Doctor of
Philosophy in Accounting in the Jomo Kenyatta University of
Agriculture and Technology**

2018

DECLARATION

This thesis is my original work and has not been presented for a degree in any other university.

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DEDICATION

I dedicate this research thesis to my beloved parents, the late Duncan Mwangi Gachuhi and Margret Njeri Mwangi for ensuring that I went through formal education amidst many challenges. To my wife, Agnes Nyambura and children: Jeddy Mwangi Kirubi, Jude Gachugu Kirubi and Hope Njeri Kirubi, it's daddy's sincere hope and wish that this study will inspire you to attain the highest level of education.

ACKNOWLEDGEMENTS

I express my sincere gratitude to all the people who offered their assistance and encouragement during the development of this thesis. Special thanks to my supervisors Dr Memba Florence, Prof. Willy Muturi and Dr J. Oluoch Oluoch for the overwhelming support accorded both in guidance and in contribution to my research knowledge, improving my research work and creating a flexible and friendly environment for need based consultation. A debt of gratitude to my family, for their encouragement and emotional support, without which, this journey would not have been possible. Finally, many thanks to my friends and colleagues, whose insights and inspirations assisted in this study

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ABBREVIATIONS AND ACRONYMS

AC	Audit Committee(s)
AICD	Australian Institute of Company Directors
ANOVA	Analysis of Variance
AUASB	Auditing and Assurance Standards Board
BRC	Blue Ribbon Commission
CEO	Chief executive Officer
CSRC	China Securities Regulatory Commission
CMA	Capital Markets Authority
FASB	Financial Accounting Standards Board
FRQ	Financial Reporting Quality
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting and Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICPAK	Institute of Certified Public Accountants of Kenya
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
KCC	Kenya Cooperative Creameries
KMC	Kenya Meat Commission
KS	Kolmogorov-Smirnov
MBA	Master of Business Administration
NSSF	National Social Security Fund
NZICA	New Zealand Institute of Chartered Accountants
OLS	Ordinary Least Square
PAC	Public Accounts Committee

PCAOB	Public Company Accounting Oversight Board
PFMA	Public Financial Management Act
PFMR	Public Financial Management Reforms
PIC	Public Investments Committee
PSCGT	Private Sector Corporate Governance Trust
ROE	Return on Equity
SCAC	State Corporations Advisory Committee
SEC	Securities & Exchange Commission
SOX	Sarbanes Oxley Act
TMTs	Top Management Teams
UK	United Kingdom
USA	United States of America
VIF	Variance Inflation Factor

DEFINITION OF KEY TERMS

Audit committee: A committee established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer (Sarbanes Oxley Act, US, 2002).

Audit: An examination of financial statements of an issuer by an independent public accounting firm in accordance with the rules of the board or commission for the purpose of expressing an opinion on accuracy and completeness of such statements. (Sarbanes Oxley Act, US, 2002).

Financial reporting quality: The precision with which financial reporting conveys information about the firm's operations or compliance of accounting standards of a particular country, or the extent to which the published financial statements and related disclosures capture the essence of the operations and financial position of the reporting entity (Robinson & Munter, 2004).

Financial statement: This is a formal record of the financial activities and position of a business, person or any other entity (IASB, 1998).

State Corporation: A body corporate established by or under an Act of Parliament or other written law (Republic of Kenya, 1987).

ABSTRACT

The purpose of this study was to establish the effect of audit committee characteristics on quality of financial reporting in non-commercial state corporations in Kenya. Specifically, the study established the effect of audit committee independence, diversity, financial competence and meetings on quality of financial reporting. All the non-commercial state corporations were studied. The study was founded on agency theory, stewardship theory, the policeman theory, lending credibility theory, theory of inspired confidence and stakeholder theory. Empirical evidence on influence of audit committees on quality of financial reporting was reviewed analysed and research gaps identified. The study adopted descriptive research design and the target population of the study was the seventy two non-commercial state corporations that existed subsequent to the introduction of Treasury guidelines in 2005 on formation and operationalization of audit committees in the public sector. The study used census on all 72 state corporations. The study employed purposive sampling to select the respondents from the target population. The study used primary and secondary data. Primary data was obtained from administration of the questionnaires and the secondary data obtained from the Kenya National Audit Office annual reports, Audited Financial statements of state corporations and Finance Bills of the respective financial years. Descriptive statistics used were frequencies, mean and standard deviation, while inferential statistics used are correlation and regression analysis. Regression analysis was employed to measure relationships between dependent and independent variables. The findings from both correlation and regression analysis revealed that audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings had statistical significant relationship with the quality of financial reporting. The results revealed that audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings reduced the ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. From the findings, the study concluded that audit committees of non-commercial state corporations must have high level of independence, diversity, financial competence and hold quality meetings in order to enhance the quality of their financial reporting. The study recommended that audit

committees in non-commercial State Corporation should be as independent as possible. Independence has been accepted as a good practice in corporate governance. This study also recommended that when constituting audit committees in state corporation consideration should be put on diversity. Audit committees should consist of diversified members. This is because demographic diversity of audit committee influences the quality of firm's financial reporting. The study also recommended that audit committees should consist of members with knowledge in accounting and finance which provides a good basis for audit committee members to examine and analyse financial information. The limitations of the study included inconsistency in the secondary data sources especially on the quality of financial reporting. The study was also limited by busy schedule of the respondents who were mainly heads of audit department. The study recommended that future studies should focus on establishing the effect of board characteristics on the quality of financial reporting in state corporations

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

An audit committee in an organisation is appointed by the board of directors to assist the board in fulfilling their oversight responsibility to stockholders, potential stockholders, the investment community and others relating to the institution's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the internal audit function, the annual independent audit of the institution's financial statements, the independent auditors' qualifications and independence and the legal compliance and ethics programs as established by management and the board. In so doing, it is the responsibility of the audit committee to maintain free and open communication between the audit committee, the independent auditors, the internal auditors and management of the Company (Salehi, Salehi, Shirazi & Shirazi, 2016).

Audit committees are identified as effective means for corporate governance that reduce the potential for fraudulent financial reporting. They can be very effective not only in providing objective oversight of the accounting of an organization, but also in helping to set an ethical "tone at the top" (Locatelli, 2002; Stein, 2003). Corporate governance includes relationships and accountability of the organization's stakeholders, as well as the laws, policies, procedures, practices, standards, and principles which may affect the organization's direction and control (Cadbury, 1992). It also includes reviewing the organization's practices and policies in regard to the ethical standards and principles, as well as the organization's compliance with

its own code of conduct. As a corporate governance monitor, the audit committee should provide the public with correct, accurate, complete, and reliable information, and it should not leave a gap for predictions or uninformed expectations (BRC, 1999).

The Sarbanes Oxley Act of the United States defines an audit committee as “a committee established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer” (United States of America, 2002). It forms part of the governance structure of an entity and is arguably the most important and challenging sub-committee of any board of directors. Cadbury’s committee report on the financial aspects of corporate governance concluded that an audit committee “has the potential to improve the quality of financial reporting by reviewing the financial statements on behalf of the board” (Cadbury Committee Report, 1992).

The primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making (IASB, 2008). Providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency (IASB, 2008). The accounting scandals of the early 2000s (Catanach & Rhoades, 2003) clearly demonstrate the importance of quality of financial reporting. However, the interpretation of quality of financial reporting remains problematic due to different

financial reporting environments, regulations, procedures, and understandings. One good definition on aspects of quality issues in financial accounting is from the corporate report of the Accounting Standards Steering Committee, Institute of Chartered Accountants in England and Wales (ICAEW, 1975), which identifies seven qualitative characteristics viewed as desirable for the fulfilment of their fundamental objective of communicating decision-useful measurements: relevance, understandability, reliability, completeness, objectivity, comparability, and timeliness. The focus of this study was to establish the influence of audit committees on the quality of financial reporting in non-commercial state corporations in Kenya.

1.1.1 Role of Audit Committees

According to Wong (2012) the main role of an audit committee in any organisation is to assist the board or a departmental head in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control over financial reporting, the audit process, and the organization's process for monitoring compliance with laws and regulations. To perform its role an audit committee must be established and be empowered with the authority to perform its duties.

The existence of the audit committees can be dated back to the 1990s. This may be attributed to the Cadbury Committee Report of 1992, which recommended all public entities to establish properly constituted audit committees as an important step in raising standards of corporate governance (Collier, 1996). The main recommendation of Cadbury's report was that audit committees should comprise a minimum of three non-executives. By the end of the 1990s, both the US and the UK had in place a system of regulation whereby public entities were expected to possess independent

audit committees. However, the dramatic failure of Enron in the US in 2001, despite the presence of a significant level of audit committee self-regulation, forced a re-think on the part of regulators and governments, not only in the US and UK, but throughout the developed world (Fichtner, 2010).

In the UK, the response was the establishment of the Smith Review (Smith Committee, 2003) which provided a detailed set of recommendations for improving the governance role of audit committees which were subsequently included in the revised version of the Combined Code published in 2003. Subsequent revisions of the Combined Code in 2006 and 2008 as well as the UK Corporate Governance Code (Financial Reporting Council, 2010) have essentially carried forward the existing recommendations for audit committees as suggested by the Smith Report (Smith Committee, 2003). Similar regulatory initiatives were introduced in many other countries for example, Australia, New Zealand, Spain, Singapore and China (Fichtner, 2010).

The Private Sector Corporate Governance Trust (PSCGT) in conjunction with the Common wealth Association for Corporate Governance produced a sample code of best practice for corporate governance in June 2000. One of the key recommendations in the code was that companies should establish audit committees composed of independent non-executive directors to keep under review the scope and results of audit, its effectiveness and the independence and objectivity of the auditors. Similarly, developing countries followed suit in creation of the audit committees in the public sector. In Kenya for instance, audit committees were first established in Kenyan Government ministries in August 2000 as part of Public

Finance Management Reforms Strategy through Treasury Circular No. AG/3/080/6 of 8th August, 2000.

The aim of setting up an audit committees in the public sector is to improve public governance (Kamolsakulchai, 2015). As a sub-committee of the governing body, an audit committee aims to provide assurance on financial and compliance issues through increased scrutiny, accountability, and the efficient use of resources. An audit committee may also serve an advisory function aimed at performance improvement within the organisation.

Audits serve a vital economic purpose and play an important role in serving the public interest to strengthen accountability and reinforce trust and confidence in financial reporting by reducing the agency problem between citizens and government (Loft, Humphrey & Turley, 2006). In the literature available, auditors serve as “watchdogs” of the executive and the bureaucracy to improve transparency, fight misappropriation, fraud, corruption, wasteful usage of public funds, and general inefficiencies (Schelker, 2008).

In the Kenyan public sector and because of the recognition accorded to accurate and quality financial reporting by several interested parties, the establishment of effective audit committees has been included in audit committee legislation through the issue of Treasury Circular 16 of 2005 and the Public finance management Act of 2012 requiring all the public sector entities, to establish audit committees. The main purpose of these committees is to ensure proper financial reporting and accountability in the usage of public resources.

1.1.2 Quality of Financial Reporting in the Public Sector

Recently financial reporting quality became an interesting topic that receives a lot of debate among accounting standards regulators, professionals, as well as practitioners. The accounting scandals of the early 2000s clearly demonstrate the importance of quality of financial reporting. However, the interpretation of quality of financial reporting remains problematic due to different financial reporting environments, regulations, procedures, and understandings (Zheng, 2010). There are different definitions of quality of financial reporting. Some of the seven qualitative characteristics quality issues in financial accounting viewed as desirable for the fulfilment of their fundamental objective of communicating decision-useful measurements include relevance, understandability, reliability, completeness, objectivity, comparability, and timeliness (Honu & Gajevszky, 2014).

In financial accounting, financial reporting quality may be judged from a number of proxies such as earnings persistence, predictability of future performance, earnings variability, and relation between cash, accruals and income (Bushman & Piotroski, 2006). Li, (2010) found that accounting standards are the major determinant of financial reporting quality among other institutional factors. In order to have high quality financial reporting the accounting standards must first be of high quality.

Van Beest, Braam and Boelens (2009) on their part posited that since different user groups will have dissimilar preferences, perceived quality will deviate among constituents. In addition, the users within a user group may also perceive the usefulness of similar information differently given its context. As a result of this context and user-specificity, measuring quality directly seems problematic.

Consequently, many researchers measure the quality of financial reporting indirectly by focusing on attributes that are believed to influence quality of financial reports, such as earnings management, financial restatements, and timeliness (Barth *et al.*, 2008).

In 2002, the IASB and the FASB showed their commitment towards developing a common set of high-quality accounting standards, which could be used worldwide. As a consequence of the joint project to converge the more principles-based IFRS and the more rules-based US GAAP, both boards agreed to develop new joint conceptual framework, which includes the objectives of financial reporting and the underlying qualitative characteristics on which accounting standards ought to be based. In May 2008, the FASB and the IASB therefore published an exposure draft of 'An improved Conceptual Framework for Financial Reporting (IASB, 2008). Some of the measure contained in the conceptual framework included relevance, faithful representation, understandability, comparability and timeliness.

1.1.3 Audit Committees and Quality of Financial Reporting

Audit committee expertise is another characteristic that has been linked to audit committee effectiveness and has received considerable attention in the prior literature. Madawaki and Amran (2013) highlighted that the search for a mechanism to ensure reliable and high quality financial reporting has largely focused on the structure of audit committees whose function is to oversee the financial reporting process and to audit financial statements.

Given the importance of audit committees, Madawaki and Amran (2013) further argued that listed companies in Nigeria are required to include in their annual reports

a summary of activities carried out by their audit committees. Nigeria for instance has witnessed a series of corporate collapses and related frauds that have raised doubts about the credibility of corporate governance in the country. A number of professional and regulatory bodies thus recommended reforms to improve the quality of financial reporting in the management and control of corporations by establishing the audit committees.

Improved financial reporting quality has been cited as one of the major benefits for companies' establishing audit committees. Studies of Baxter and Cotter (2009), Davidson, Godwin-Stewart, and Kent (2005), Yang and Krishnan (2005), and Abbott, Parker, and Peters (2004) found that independent audit committee members are more objective and less likely to overlook possible deficiencies in the manipulation of financial reports. The results of the above studies further suggested that financial reporting quality improved in the year after the formation of audit committees compared with the year before. The results also indicate that audit committees independence and expertise are positively associated with improved financial reporting quality.

Audit committees have been held up by some as one of the biggest corporate governance success stories in the UK over the last twenty years or so. The financial crisis of 2008 and the resulting economic climate have put the governance role of audit committees firmly in the spotlight (Tricker & Tricker, 2015). The committee is seen as playing a key role in the restoration of trust in company financial reporting and has wide-ranging, time consuming and intensive work to do. It is likely that even

greater focus is to be placed on them in the UK in the future although this trend is not necessarily reflected in the rest of the world (Milhaupt & Pistor, 2008).

According to Carcello and Neal, (2003) results indicated that whilst the vast majority of audit committee reports surveyed did a good job in summarising the role of the audit committee many were let down by the description of how the audit committee had actually discharged those responsibilities. Davidson *et al.* (2005) argues that to ensure good corporate governance, the effectiveness of the Board of Directors and particularly that of the non-executive directors is to be enhanced by the establishment of appropriate board sub-committees. The Audit committee is one of the sub-committees of the board. An audit committee, which mainly comprises of non-executive directors, can be an effective tool to ensure corporate governance in an organisation (Baxter & Cotter, 2009).

Dechow, Ge and Schrand (2010) posited that, the ability to adequately supervise the activities and constrain opportunistically managed earnings lies with effective internal corporate governance mechanism. Thus, internal governance mechanisms involve among others, the formation of independent audit committee that would supervise the activities of managers and ensure strict compliance with the financial regulations.

Madakawi (2012) also highlighted that the audit committee comprise of three non-executive board members and three shareholders representatives. The idea of splitting the audit committee membership into an equal number of representations is to ensure the independence of the committee, thereby creating more confidence in the board activities, enhanced financial control and more credibility to the workings

of the committee and company's financial reporting process. Accounting or financial expertise are attributes, qualification or experience acquired by a person before becoming a board member of a company.

Carcello, Hollingsworth, Klein and Neal (2006) document that, there is a reduction in the use of discretionary accruals and income-increasing accruals when accounting expert is on the Audit Committee (AC). Also, Xie, Davidson and DaDalt (2003) suggest that AC members need financial sophistication to curtail managers from engaging in earnings management (EM) practices. Hoitash, Hoitash and Bedard (2009) document that firms with a high proportion of financial experts not necessarily accounting experts are unlikely to report weaknesses in the internal control over financial reporting. Consequently, Badolato, Donelson and Ege (2014) argue that it is not enough to have accounting/ financial expert as a member of ACs in constraining EM, but a combination of financial expertise and high status of the AC members.

Issues of diversity in corporate governance can be discussed based on several recognized theories. Westphal and Milton (2000) provide the argument in the perspective of an agency theory. They argue that board diversity in terms of gender and ethnic minorities can help correct information bias in strategies formulation and problem solving. Carter *et al.* (2003) also suggest that greater gender diversity may improve the board as one of the internal governance mechanism to monitor the managers' activities. This is because female directors like to ask questions that may not be asked by male directors.

Fields and Keys, (2003) raise the same issue through stakeholder theory as the pressure of firms to appoint female as directors comes from a broad set of people, which includes shareholders, activists and large institutional investors. In addition, Herring (2009) view the contribution of board diversity based on the Upper Echelon Theory. They argue that characteristics of the top management team who, with greater demographic diversity, have a great power to influence the decision-making process of the organisation and can positively contribute to the firm's performance.

Audit committee expertise refers to the audit committee members who have the knowledge and experiences in accounting and financial reporting, internal controls and auditing. Experts are expected to have greater ability towards directing on financial reporting quality over non-expert auditors, including a better understanding of risks and on auditor's opinions. The above notion is supported by evidence in previous studies.

For example, studies of DeZoort and Salterio (2001) and Bédard (2004) found that audit committee members with accounting and financial expertise provide more support on auditing output and to reduce problems on auditor's disagreement, as well as to confine earnings management. It is expected to increase the frequency of committee meetings (Stewart, 2007). To become more effective, committee members ought to be willing to devote more of their time for auditing (Lee & Mande, 2005). Discretion of the executive is a part of financial reporting that can be manipulated according to their requirements in order to achieve their goal of operation, by the use of earnings management. However, administrators or the authority intend to modify

performance to comply with their needs by any means, such as earnings or accounting manipulation that can be managed through optional accounting standards.

Adjustment on accounting policy to reflect business would affect users' decision on financial statements that requires a high quality financial reporting. Audit committees are responsible for considering hiring and examining the performance of auditors, and considering impacts of audit quality on the relationship between audit committee effectiveness and financial reporting quality (Cohen, 2004).

1.2 Statement of the Problem

Despite the legislation that has been enacted to establish effective audit committees with the required characteristics in the public sector in Kenya as well as clear responsibilities for financial reporting and accountability, there have been reported cases of failure or near failure of several state corporations among them the National Social Security Fund (NSSF), the Kenya Meat Commission (KMC), Kenya Cooperative Creameries (KCC) due to fraudulent financial reporting (Ogoro & Simiyu, 2015). Pucheta-Martínez and De Fuentes (2007) further noted that the collapse of large corporations highlighted the intentional misconduct due to the weakness of corporate governance particularly audit committees, as they are not effective enough to protect investors from loss. Companies have gone into liquidation for reasons bordering on ineffective or non-existing system of audit committee.

The Institute of Certified Public Accountants of Kenya, (ICPAK) conducted a survey in 2015 on establishment and effectiveness of audit committees in Kenya's public sector. As one of its objectives, the survey sought to find out whether state

corporations had complied with the issued National Treasury Circular No. 16/2005 on establishment of audit committees. The survey found that ninety five percent (95%) of the respondents had established audit committees as per the circular. It further established that most entities had established the committees within three years of issuance of the circular in August 2005. It was also observed that under the purely commercial entities, the financial institutions had established audit committees prior to the circular under the CMA Guidelines of 2002. The question therefore is why, with all the legislation as well as having fully established and functional audit committees, are there still qualified, disclaimer and adverse opinions on financial reports of state corporations issued by the Auditor General.

Recent research suggests that effective audit committee characteristics are fundamental determinants of high-quality financial reporting (Boonlert-U-Thai & Kuntisook, 2009; and Dangana & Yancy 2013). Kibiya, Che-Ahmad and Amran (2016) focus on audit committee independence, financial expertise, share ownership and financial reporting quality. The authors noted that the idea of splitting the AC membership into an equal number of representations is to ensure the independence of the committee, thereby creating more confidence in the board activities, enhanced financial control and more credibility to the workings of the committee and company's financial reporting process. However, in public sector little has been done to ascertain the influence of audit committee independence and the quality of the financial reporting.

Research on the influence of audit committees meetings and quality of financial reporting has focused on companies. For instance Yin, Gao, Li and Lv (2012) and

Kamarudin, Ismail and Alwi (2014) studies focused on the determinants of audit committee meeting frequency in limited companies. This study focused on establishing the influence of audit committee meetings and quality of financial reporting in non-commercial state corporations in Kenya. Similarly, studies on the relationship between audit committee independence and quality of financial reporting have been conducted in different context other than non-commercial state corporations in Kenya.

This study seeks to bridge this knowledge and contextual gap by analysing the audit committee characteristics and quality of financial reporting in non-commercial state corporations in Kenya since the findings of previous studies have not directly linked audit committee characteristics with quality of financial reporting as measured by the transactions that are not properly accounted for as contained in the independent audit opinion of the Auditor General. Similarly, other studies have used commercial state corporations which may not necessarily be used to generalize on all state corporations due to the commercial nature of the enterprises. The study hypothesizes that quality of financial reporting depends on audit committee characteristics and hence, the specific focus of the study is to establish the effectiveness of audit committee independence, diversity, financial competence and meetings on quality of financial reporting in non-commercial state corporations in Kenya.

1.3 Objectives of the Study

1.3.1 General objective of the study

The general objective of this study was to establish the effect of audit committee characteristics on quality of financial reporting in non-commercial state corporations in Kenya.

1.3.2 Specific objectives of the study

1. To examine the effect of audit committee independence on quality of financial reporting in non-commercial state corporations in Kenya.
2. To establish the effect of audit committee diversity on quality of financial reporting in non-commercial state corporations in Kenya.
3. To determine the effect of audit committee financial competence on quality of financial reporting in non-commercial state corporations in Kenya.
4. To evaluate the effect of conduct of audit committee meetings on quality of financial reporting in non-commercial state corporations in Kenya.
5. To examine the moderating effect of system automation and staff competence on the relationship between audit committees and quality of financial reporting in non-commercial state corporations in Kenya

1.4 Hypotheses

H₀₁: Audit committee independence has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

H₀₂: Audit committee diversity has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

H0₃: Audit committee financial competence has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

H0₄: Conduct of audit committee meetings has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

H0₅: System Automation and staff competence do not significantly moderate the relationship between audit committee characteristics and quality of financial reporting in non-commercial state corporations in Kenya.

1.5 Justification of the Study

In the reform platform, audit committees play a vital role in enhancing corporate governance in the public sector by providing oversight over the institution's governance, including the organization's system of internal controls. Therefore an audit committee that operates effectively is a key feature in a strong corporate governance culture, and can bring significant benefits to the entity.

1.5.1 Government, Regulatory Bodies and Relevant Ministries

The study findings may be of great value to the Government of Kenya towards enhancing accountability as well as quality of financial reporting among its state corporations. It may help in improving guidelines on appointment and management of audit committees of state corporations towards making them more effective in their roles and responsibilities. This may include issuing additional guidelines as well as formulating laws that may make the committees better in guiding the process of managing public resources. At the centre of contemporary management in public sector is corporate governance which the audit committee is a central contributor.

Regulatory bodies like ICPAK and State Corporation Advisory Committee (SCAC) may use the study findings to make recommendations on appointment of audit committees.

1.5.2 Academicians and Scholars

The study will also provide empirical findings that may be of importance to researchers and students in the areas of Finance, Accounting and Audit. These findings may be used to improve understanding of the concept of audit committees in the public sector and suggest various ways of improving their effectiveness in their roles of vetting the quality and integrity of financial statements of State Corporations. Additionally, the study may result in an improved understanding of the relationships between the audit committee characteristics and financial reporting. The study findings will be an addition to existing literature on audit committees in Kenya as well as give comparison to similar past studies conducted in developed and developing economies on audit particularly for public sector entities.

1.5.3 Theory Building

This study expounded on the utility of the theories adopted. The study expounded the use of agency theory, stewardship theory, the policeman theory, lending credibility theory, theory of inspired confidence and stakeholder theory to explaining the relationship between audit committee characteristics and quality of financial reporting in non-commercial state corporations in Kenya. Therefore future researchers in this field may also use the same theories. The study further expanded the available literature on the relationship between audit committee characteristics and quality of financial reporting by using them as a source of references. This study

adopted a descriptive research design and regression analysis to quantify the effect of independent variables on the dependent variable. Therefore, future scholars may use similar methodology when carrying out related studies.

1.6 Scope of the Study

The study focused on audit committee characteristics and quality of financial reporting for the financial years 2006/2007 to 2011/2012. This was because the enhanced guidelines on the formation and operationalization of audit committees in the public sector became effective in October 2005 which is almost mid-financial year and therefore proper adoption may not have fully taken place in the remaining period of that financial year.

The period between 2006 and 2012 was selected since the financial statements for state corporations that had been audited by the time of research were up to financial year 2012. The population for this study comprised of all seventy two (72) non-commercial state corporations that existed in Kenya in the financial year 2006/2007 to 2011/2012. The studies that have been done dwelt on commercial state corporations and none has related audit committee characteristics to quality of financial reporting in non-commercial state corporations in the Kenyan context.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarised the views of other researchers who have carried out their research in the same area of audit committees and financial reporting. The chapter covers the theoretical and empirical literature, as well as the conceptual framework and research gaps identified in the researches.

2.2 Theoretical Framework

This section focused on theories that attempt to explain the background and historical developments of the study variables. This study was anchored on agency theory, stewardship theory, the policeman theory, lending credibility theory, theory of inspired confidence and stakeholder theory.

2.2.1 Agency Theory

The origins of the agency theory can be traced back to Jensen and Meckling (1976) and the discussion of the problem of the separation of ownership and control. Jensen and Meckling (1976) suggested that managers of other people's money cannot be expected to watch over it with the same anxious vigilance one would expect from owners and that negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. They defined the relationship between the principals, such as shareholders and agents such as the managers and held that managers will not on their own act to maximise the returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders (Jensen & Meckling, 1976).

Proponents of agency theory argue that ownership and control separation lead to moral hazard problems, where agents act to obtain personal benefits at the expense of shareholders. To curtail such behaviour, effective control by the board would greatly help. The effectiveness of the board monitoring depends among others, on sub-committees of the Board (Kibiya, Che-Ahmad & Amran, 2016). Also Shi and Zhou (2012) argue that board audit as a sub-committee and their financial expertise are found to affect the level of the way managers manipulate earnings to achieve corporate or personal benefit.

Similarly, Dhaliwal, Naiker and Navissi (2010) posit that the ability to adequately supervise the activities and constrain opportunistically managed earnings lies with effective internal corporate governance mechanisms. Internal governance mechanisms involve among others, the formation of an independent audit committee that would supervise the activities of managers and ensure strict compliance with the financial regulations. However, the effectiveness of the committee depends on its composition and the expertise of its members. Also, the impact of high status industry experience (Kibiya, Che-Ahmad & Amran, 2016), accounting expertise and accounting and industry experts (Cohen *et al.*, 2014) have been subject to conflicting findings.

Bradbury (1990) analysed the incentives for voluntary formation of audit committees. The results of this study indicated that while agency cost variables and audit firm size had no associations with audit committee formation, the number of directors on the board and intercorporate ownership were found to be important determinants of voluntary audit committees. Willekens *et al* (2004) investigated the

associations between the voluntary formation of audit committees and some factors that could influence such formation using data from Belgian listed companies. They found that while the proportion of independent directors on the board and the size of the external audit firm were positively associated with the voluntary formation of audit committees, agency costs and board size were not related to the voluntary formation of such committees.

Cohen, Krishnamoorthy and Wright (2004) conducted a survey to examine the perceptions of audit committee chairs, management, external auditors and internal auditors about agency conflict. They found evidence that agency conflicts exist between audit committees and management in areas related to financial disclosure and discretionary accounting procedures. However, the perceptions of audit committee chairs regarding issues affecting accounting choices were different from those of internal and external auditors.

Dinu and Nedelcu (2015) employed agency theory in explaining transparency and quality of financial disclosures in the case of Romanian listed companies. Kołodkiewicz (2014) also analysed the main agency problems and their consequences. Similarly, Nayeri and Salehi (2013) analyse the role of the agency theory in implementing management's control. This study will add to the existing literature by adopting the agency theory in explaining the relationship between audit committee characteristics and quality of financial reporting in non-commercial state corporations. Audit committees act for the interests of shareholders and therefore a properly functioning audit committee has a major role in forestalling agency conflicts that may arise between shareholders and management. According to agency theory,

quality financial reporting will be realized when conflicting interests are solved in good time a role that can be effectively played by the audit committees.

2.2.2 Stewardship Theory

Stewardship theory has its roots from psychology and sociology and it stresses on the role of top management being as stewards, integrating their goals as part of the organization as opposed to the agency theory perspective (Argyris & Schon, 1974). The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. It is based on a model of man where a steward perceives greater utility in cooperative, pro-organisational behaviour than in self-serving behaviour; the theory assumes a strong relationship between organisational success and a principal's satisfaction. Hence, a steward overcomes the trade-off by believing that working towards organisational, collective ends meet personal needs as well (Penman, 2007).

The theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson & Davis, 1991). In order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Abdullah and Valentine (2009) contend that executives and directors are also managing their careers in order to be seen as effective stewards of their organization.

The theory also holds that managers do have similar interests to the corporation, in that the careers of each are linked to the attainment of organisational objectives, and

their reputations are interwoven with the firm's performance and shareholder returns (Mattor & Cheng, 2015). Tricker (1984) described accountability in stewardship theory as the means by which those who manage and oversee the affairs of the company are held to account for their stewardship of corporate assets.

The International Accounting and Standards Board (IASB) and Financial Accounting Standards Board (FASB) are currently developing a common conceptual framework which reflects financial statements as a sign of stewardship of the agents to the principals. The previous IASB Framework issued in 1989 referred to stewardship as follows: Financial statements, in addition to providing information that is useful in making economic decisions, show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management (IASB, 1989).

Accountability refers directly to the fact that, not only do management have the responsibility to use the assets entrusted to them for the benefit of shareholders, they also have the overriding obligation to provide those shareholders with an account of what it has done with those assets. This means that management are accountable to the entity's capital providers for the custody and safekeeping of the entity's economic resources and for their efficient and profitable use, including protecting them from unfavourable economic effects such as inflation and technological

changes. Management are also responsible for ensuring compliance with laws, regulations and contractual provisions.

Financial statements therefore provide a key condition for the existence of a stewardship objective. Shareholders look to financial reporting to access information relating to management's stewardship of the business. Perhaps it is for this reason that stewardship is characterized as a demand for information on management's safe custody of the assets, and compliance with laws and regulations.

The stress is on whether management have behaved properly and not for example, unjustly enriched themselves at the company's expense. The audit committee is therefore at the centre of ensuring that proper financial policies and controls are put in place to ensure the stewards achieve both owner's objectives and their stewardship objective as well. The committee must have the ability to oversee management behaviour to ensure that it is aligned to the owners' objectives, management are devising strategies aimed at making the best use of assets and no misappropriation of the company assets takes place. This is however confirmed by the independent report of the external audit as detailed in his opinion on financial statements.

Stewardship theory holds that certain managers possess innate goodness, pursuing the maximal benefit to shareholders as a primary objective and valuing their commitments toward the organization (Chiang, Li-Jen & Shiao, 2015). In organizations, these managers play the roles of stewards, safeguarding the benefits of the corporation.

Manager behaviour is driven by social perceptions and self-achievement. Thus, the self-interests of managers and benefits to the company and all company personnel

are mutually linked, and no conflicts arise (Al Mamun, Yasser & Rahman, 2013). The perspectives of these scholars are biased toward stewardship theory, maintaining that managers are influenced by self-actualization and morals, often electing to do things that benefit the company and avoiding poor social behaviours, even if doing so reduces the short-term benefits to corporate stakeholders. Thus, managers are not affected by self-interests when they promote corporate policies. According to this theoretical perspective, managers avoid behaviours that harm the company, demonstrating self-restraint and not using Corporate Social Responsibility (CSR) to conceal earnings manipulations. This reduces the degree of earnings management by managers, resulting in high-quality financial reports (Chiang, Li-Jen & Shiao, 2015).

Lennard (2007) noted that stewardship contributes an important dimension to financial reporting, which should be reflected by specific acknowledgement in the objectives of financial reporting. Moreover, stewardship should not be characterised simply as information to assist an assessment of the competence and integrity of 'stewards' (i.e. management, directors) but as the provision of information that provides a foundation for a constructive dialogue between management and shareholders. Europe (2007) focused on stewardship/accountability as an objective of financial reporting. The findings revealed that stewardship/accountability has implications for financial reporting. The author further suggested that shareholders look to financial reporting to access information relating to management's stewardship of the business.

Chiang, Li-Jen and Shiao (2015) adopted the stewardship theory in explaining the relationship between financial reports quality and corporate social responsibility.

O'Connell (2007) also analysed the reflections on stewardship reporting. Few studies have used the stewardship theory in analyzing the effects of audit committee characteristics on the quality of financial reporting hence this study seek to address this theoretical research gaps.

This theory is relevant to the study since the audit committee ensures that proper financial policies and controls are put in place to ensure the stewards achieve both owner's objectives and their stewardship objective as well. The committee must have the ability to oversee management behaviour to ensure that it is aligned to the owners' objectives, management are devising strategies aimed at making the best use of assets and no misreporting of financial transactions takes place. Therefore, the theory helps in explaining the relationship between audit committees and quality of financial reporting in that if the audit committee fails to put the steward (management) at check, self-interests will overrun organisation interests hence fraudulent financial reporting.

2.2.3 The Policeman Theory

The policeman theory claims that the audit and assurance process is responsible for searching, discovering and preventing fraud. This was the case in the early 20th century. However, more recently the main focus of this process has been to provide reasonable assurance and verify the truth and fairness of the financial statements. The detection of fraud is, however, still a hot topic in the debate on the auditor's responsibilities, and typically after events where financial statement frauds have been revealed, the pressure increases on increasing the responsibilities of auditors in detecting fraud and manipulation of financial information.

This was the most widely held theory on auditing until the 1940s (Hayes, Schilder, Dassen & Wallage, 1999). Up until the 1940s it was widely held that an auditor's job was to focus on arithmetical accuracy and on prevention and detection of fraud. However, from the 1940s until the turn of the century there was a shift of auditing to mean verification of truth and fairness of the financial statements. Recent financial statement frauds such as those at Societe Generale, Satyam, Ahold, Enron have resulted in careful reconsideration of this theory. There now is an ongoing public debate on the auditor's responsibility for detection and disclosure of fraud returning us to the basic public perceptions on which this theory derives.

According to this theory, the audit committees should put in place mechanisms to detect fraud before it happens just like a policeman tries to prevent crime from happening. In terms of quality of financial reporting, audit committee is viewed to perform the duty synonymous to that performed by the policemen such as to check and detect any instances of frauds in the organisations. Therefore audit committee that are independent, diversified, financially competent and have quality meetings is perceived to exercise their mandate more effectively. For instance Elder *et al.* (2009) stated that the most common way for users to obtain reliable information (reducing the information risk) is to have an independent audit committee.

Similarly, DeZoort *et al.* (2002) asserted that an effective audit committee could protect stakeholders' interests by ensuring reliable financial reporting, effective internal control, and high quality risk management. Turley and Zaman (2004) also pointed out that understanding the impact of audit committees as policemen could assist in formulating appropriate expectations about the audit committee function,

based on which the effectiveness of audit committees could then be assessed. Salehi, Rostami and Mogadam (2010) also adopted policeman theory in explaining the usefulness of accounting information system in emerging economy. This study will adopt the policemen theory in assessing the role of audit committees on quality of financial reporting among non-commercial state corporations in Kenya.

As mentioned earlier policeman theory claims that the audit and assurance process is responsible for searching, discovering and preventing fraud, therefore audit committees acting as organisation policeman go a long way in ensuring quality financial reporting.

2.2.4 Lending Credibility Theory

The lending credibility theory suggests that the primary function of the audit process is to add credibility to the financial statements. Audited financial statements are seen to have elements that increase the financial statement users' confidence in the figures presented by the management. The users' are perceived to gain benefits from the increased credibility and these benefits are typically considered to be that the quality of investment decisions improve when they are based on quality and reliable information (Hayes *et al.*, 1999).

Audited financial statements are used by management to enhance the stakeholders' faith in management's stewardship. If stakeholders such as stockholders, government, or creditors have to make their judgments based on the information they receive, they must have faith that this is a fair representation of the economic value and performances of the organization. The audit process reduces information asymmetry whereby management knows more than the stakeholders. However,

Porter (1990) concludes, that “Audited information does not form the primary basis for investors’ investment decisions”.

On the other hand, it is often asserted that financial statements have a function of confirming a message that was previously issued (Hayes *et al.*, 1999). From the assertions of this theory, it is the duty of the audit committee to ensure that the final product of the financial reporting cycle will be beneficial in terms of quality to interested parties that may use them for decision making. As much as possible, the committee must ensure that their efforts are geared towards lending credibility to the financial statements.

High-quality financial reporting by firms is important for both internal and external evaluation of credibility of the business performance (Bushman & Smith, 2001). For internal decision-making, prior research shows that high-quality financial information helps business managers identify good projects and increase investment efficiency (Chen, Hope, Li, & Wang, 2011). For external purposes, disclosure of financial information allows providers of financial resources to better assess the firm’s investment opportunities and monitor managerial actions (McNichols & Stubben, 2008). In other words, high-quality financial reporting should ease external financing constraints by reducing the adverse selection or moral hazard costs associated with information asymmetry.

The proponents of lending credibility theory therefore argue that the need for credibility in the financial reporting should act as a motivating factor for any organisation an effective audit committee. Independent, diversified and competent audit committee will ensure quality is upheld in financial reporting of non-

commercial state corporations in Kenya. Kabiru and Rufai (2014) found that audit quality is often related to the competence and independence of audit committees as being able to detect material misstatements and being prepared to issue appropriate audit reports to reflect their findings.

The theory fits in the study by ensuring that financial reporting under the audit committees scrutiny is as accurate as possible and this adds credence to the financial statements. This gives confidence to all the stakeholders on the performance of the organisation as represented in the financial reports.

2.2.5 Theory of Inspired Confidence

This theory also known as the theory of rational expectations was developed in the late 1920s by Dutch professor Theodore Limperg (Hayes *et al.*, 1999). It was advanced to addresses both the demand and the supply for audit services. Stakeholders of an entity demand accountability from the management, in return for their investments. Accountability is realized through the issuance of periodic financial reports which are subjected to independent opinion of the external auditor.

However, since this information provided by the management may be biased and outside parties have no direct means of monitoring, audit committees should therefore be the first line of assurance towards inspiring confidence in the quality of financial statements. An audit is required to assure the reliability of this information. The audit committee and the external auditor should therefore act in such a way that they do not disappoint the expectations of a rational outsider, while, on the other hand, the auditor should not arouse greater expectations in his report than his examination justifies. So, given the possibilities of audit technology, the auditor

should do enough to meet reasonable public expectations the least of which is giving an independent opinion on the reliability of the financial statements he so audits (Solomon, 2007). This will inspire confidence to the owners of capital as well as other stakeholders especially if the auditor through his unqualified opinion confirms that the financial statements are of high quality.

Eid (2014) employed the theory of inspired confidence to test the impact of accounting information systems on performance measures with value relevance of auditors' communications. Sijpesteijn (2011) also used the theory of inspired confidence in analysing the value relevance of auditors' communication. Similarly, Ittonen (2010) included the theory of inspired confidence in theoretical examination of the role of auditing and the relevance of audit reports. This theory has been heavily utilized in the field of accounting, however very few studies have used this theory to explain the relationship between audit committees and quality of financial reporting.

According to this theory, audit committees should be the first line of assurance towards inspiring confidence in the quality of financial statements. The theory is further relevant because having properly functioning audit committees will inspire confidence to all shareholders and general public about the credibility of the financial reports and in effect create confidence in the organization.

2.2.6 Stakeholder Theory

The emergence of stakeholder theory, according to Gay (2002) was prompted by the growing recognition by boards of the need to take account of the wider interest of the society. He lists the essential premises upon which the stakeholder theory rests,

citing Jones and Wicks (1999) as being: that the corporation has relationships with many constituent groups (stakeholders) that affect, and are affected by its decisions; that the theory is concerned with the nature of these relationships in terms of both processes and outcomes and focuses on managerial decision making ; that the interest of all legitimate stakeholders have intrinsic value and no set of intrinsic value is assumed to dominate the other.

This theory maintains that the objectives and therefore results of the firm should be derived by balancing the conflicting aims of the various stakeholders in the firm: managers, workers, stockholders, suppliers, vendors. It implies that a board will be mainly interested in performance of the company in terms of meeting the expectations of stakeholders and ensuring that the reported results are beneficial to the shareholders. Such a board should be made up of directors with the right background and experience for effectiveness of their service function.

Solomon (2007) contended that a basis for stakeholder theory is that companies are so large, and their impact on the society is so pervasive, that they should discharge accountability to many more sectors of the society than solely their shareholders; they should include employees, suppliers, customers, creditors, communities in the vicinity of the company's operations, and the general public. Creditors have an interest in getting their loans repaid on schedule; suppliers have an interest in securing fair prices and dependable buyers; customers have a stake in getting value for money. Basically, this theory is used to help understand the groups and individuals that can affect, and are affected by, the achievement of an organization's

purpose, and those effects may be economic, regulatory, technological, social, political and managerial.

In support of stakeholder theory, Donaldson and Preston (1995) pointed out that managers are responsible to deploy their wise decisions and best efforts in obtaining benefits for all stakeholders. Similarly, Wang and Dudley (1992) noted that the board cannot ignore its responsibilities in safeguarding stakeholder's interests.

Corporate governance ensures the conformance of corporations with the interests of investors and society by creating fairness, transparency and accountability in business activities among employees, management and the board (Oman, 2001). Therefore, it is clear that a growing body of literature and empirical evidence argues that by taking account of all stakeholders, instead of shareholders alone, the company is more likely to achieve the long term profit maximization which is also conducive for sustainable wealth maximization. Hillman, Canella and Paetzold (2001) found that the inclusion of stakeholders on the board merely improves their relation and performance.

According to this theory, a well-functioning audit committee ensures better corporate governance practice in a firm, which ultimately leads to the overall welfare of many stakeholders. Dey's (2008) conclusion is notable in this respect, he mentioned that an organization's performance and stakeholders' value are positively affected by various governance mechanisms, including audit committee. DeZoort, Hermanson, Archambeault, and Reed (2002) emphasized stakeholder interests in the definition of effective audit committee by stating that the ultimate goal of the committee is to protect all stakeholders' interests and welfare. This is because if the financial

statements are of the highest attainable quality, then all stakeholders' interests will have been safeguarded.

Van Beest, Braam and Boelens (2009) used stakeholder theory in the analysis of quality of financial reporting using qualitative characteristics. The author highlighted that providing high quality financial reporting information is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency.

Braam and van Beest (2013) also adopted stakeholders' theory in conceptually-based financial reporting quality assessment in an empirical analysis on quality differences between UK annual reports and US 10-K reports. Similarly, Chan and Kent (2003) applied stakeholder theory to the quantity and quality of Australian voluntary corporate environmental disclosures. The basic proposition forwarded by stakeholder theory is that the success of a firm is not dependent solely upon the successful management of the firm's relationship with its shareholders. The analysis of theoretical foundation reveal there is a need to address the theoretical gaps by adopting the stakeholders' theories in explaining the relationship between audit committees and quality of financial reporting.

This theory is relevant to the study since it argues that a well-functioning audit committee ensures better corporate governance practices which will be reflected even in financial reports. This will ultimately lead to the overall confidence by the stakeholders and ensure sustained growth of the organisation.

2.3 Conceptual Framework

A conceptual framework refers to a diagrammatic representation of the theorized interrelationships of the variables of a study. The conceptualization of variables in academic study is important because it forms the basis for testing hypothesis and coming up with generalizations in the findings of the study. According to Cooper and Schindler (2011), researchers hypothesize relationships of independence and dependence. Cooper and Schindler (2011) defines dependent variable as a variable that is measured, predicted, or otherwise monitored and is expected to be affected by manipulation of an independent variable. They also defined an independent variable as a variable that is manipulated by the researcher, and the manipulation causes an effect on the dependent variable.

In this study, the independent variables are the conceptualized audit committee characteristics which include independence, diversity, financial competence and meetings. The dependent variable of the study is quality of financial reporting. The study hypothesizes that audit committee characteristics will have an effect on the quality of financial reporting of non-commercial state corporations in Kenya. The conceptual framework is presented in figure 2.1

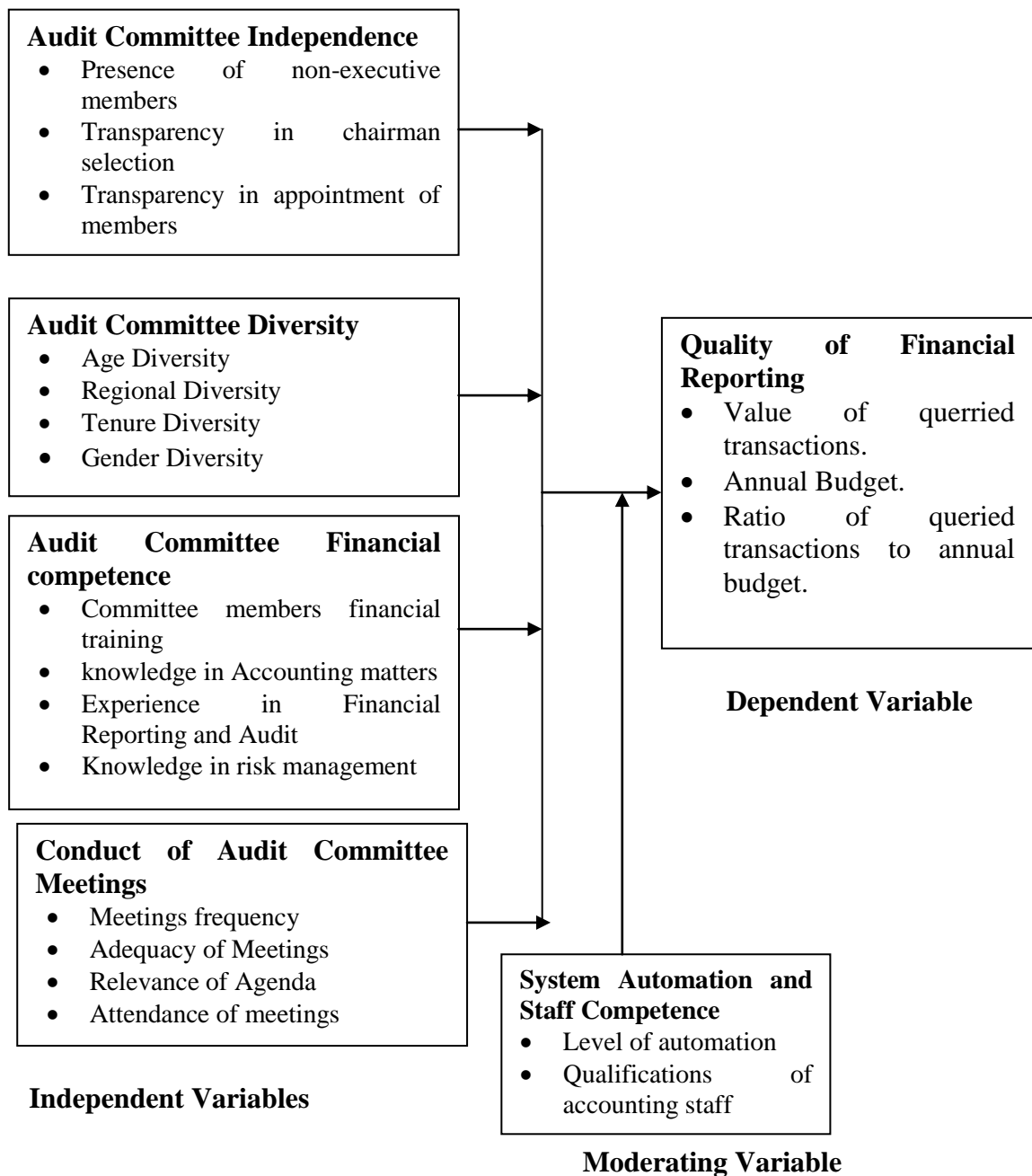


Figure 2.1 Conceptual Framework

2.3.1 Independence of Audit committees

According to DeZoort *et al.* (2002) an independent audit committee promotes the best interests of corporate stakeholders. Independence has been accepted as a good practice in corporate governance, but it still remains one of the most common variables in the audit committee research literature. However, in many aspects the audit committee independence literature produced mixed results which failed to prove the fulfilment of expectation on independent directors safeguarding the interests of investors.

Miringú and Muoria, (2011) did a study on the effect of Corporate Governance on performance of commercial State Corporations in Kenya. The study found that most of the boards are deemed independent and it concurs with John and Senbet (1998) who argues, that boards of directors are more independent as the proportion of their outside directors increases. Beasley, Carcello, Hermanson & Neal (2000) found companies that committed fraud had less independent audit committees compared to their counterparts that did not commit fraud. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals. Bedard *et al.* (2004) investigated the association between different audit committee characteristics and earnings management. They found that aggressive earnings management is negatively associated with the presence of an independent audit committee.

However, there are other studies that found no significant association of independence with effectiveness or financial statement restatements. Ogoro &

Simiyu (2015) found a significant negative relationship between audit committee independence and committee effectiveness. These results are consistent with those of Plumlee and Yohn (2010) who did not find any association between reduced financial statement restatement and the existence of majority independent directors. They reported that only the presence of an audit committee is associated with lower financial statement restatements but not necessarily independent audit committee. These findings could be attributed to the opinion that the audit committee members could be perceived as independent of the entity but this independence is eroded as they become affiliated with the management, and as a result they rely more and more on the financial rewards from the entity at the expense of committee effectiveness.

2.3.2 Diversity of Audit Committees

According to researchers, (Top Management Teams) TMTs in each organization are significant and have an effective role in determining major goals and outcomes of their organizations. Hambrick, Finkelstein and Cannella (2008) attribute quality reporting to top executives' personal characteristics but, Varman, (2010) argue that there is a significant difference between the effectiveness of TMTs and effectiveness of contextual factors. This is consistent with findings of Mackey (2008) who found strong evidence in favour of the effectiveness of TMTs' characteristics on performance. Hillery and Hsu (2011) provides evidence that top executive directors influence the output of accounting information. Cohen, Krishnamoorthy and Wright (2004); Graham *et al.* (2005) and Hambrick (2007) suggest that management demographic diversity influence the quality of firm's statements. This variation in top managers' characteristics is perceived to have an impact on firm's financial

reporting quality (FRQ) if linked with agency theory (Francois & Kyle, 2011; Ling, 2012).

Gender diversity in an audit committee is an important characteristic. This is because different genders have different attitudes and ethical conduct in performing their duties. Bilic and Sustic (2011) found that women are more ethical in performing their duties than men. The presence of women on the board enhances the ability of the business to run healthily and a female presence is considered as a complement to the male directors. Huang *et al.* (2011) argues that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income. Huang and Thiruvadi, (2010) found that Audit committees that have at least one female director function differently than all male audit committees.

2.3.3 Financial Competence of Audit Committees

The rules of the United States Stock Exchange Commission (SEC) define an audit committee financial expert as a person who has each of five attributes pertaining to a sufficient understanding of accounting principles, financial statements, internal control, and audit committee functions. According to the Combined Code of Corporate Governance in the UK (Financial Reporting Council, 2003), a board should satisfy itself that at least one of its independent nonexecutives has recent and relevant financial experience. According to the New Zealand Securities Commission (2004), financial expert refers to current membership of the New Zealand Institute of Chartered Accountants (NZICA).

Knowledge in accounting and finance provides a good basis for audit committee members to examine and analyze financial information. The educational background becomes an important characteristic to ensure audit committees perform their roles effectively. Moreover, audit committees that comprise at least one financial expert have greater interplay with their internal and external auditors (Raghunandan et al., 2001). DeZoort and Salterio (2001); Bedard and Gendron (2010) argue that members' expertise or experience is directly associated with the effective functioning of an audit committee. Since the main task of audit committee is to oversee financial reporting and the auditing process, its members should possess sufficient expertise to understand the issues to be investigated or discussed by the committee (Lin et al., 2008). The impact of having financial experts on audit committees is however two sided. On the one hand, the financial expert tends to enhance the diligence of the committee and the quality of reporting and auditing (Abbott, Parker, Peters & Raghunandan, 2003; Bédard *et al.*, 2004; Baxter & Cotter, 2008). On the other hand, financially sophisticated directors can be aggressive and risk-taking, and therefore may act in a contrary manner (DeZoort, Hermanson & Houston, 2003).

2.3.4 Audit Committee Meetings

Morrissey (2000) suggests four meetings in a year for audit committees. He further claims that the best quality of financial reports can be assured, if four sittings are held during the year. It has also been argued by Menon and Williams (1994) that for audit committees to be effective monitors, it is not enough just to be independent and that they must be active. Being active could be measured by the frequency of their meetings. The number of audit committee meetings is a perceived indicator of audit committee effectiveness. Financial statement users perceive fewer meetings as an

indicator of less commitment and insufficient time to oversee the financial reporting process. Xie *et al.* (2003) found that increased audit committee activity (the number of committee meetings) is associated with reduced levels of earnings management. Bryan, Liv and Tiras (2004) posited that audit committees that meet regularly improve the transparency and openness of reported earnings and therefore improve earnings quality.

Zhang, Zhou and Zhou (2007) used the number of meetings to measure whether frequency of meetings influences financial reporting quality and found a positive correlation. However, empirical evidence on the impact of frequency of audit committee meeting on financial reporting quality differs. Vafes (2005) found a negative relationship between the number of meetings and earnings management. Bedard, Chtourou and Courtteau (2004) and Lin *et al.* (2006) did not find any positive association between frequency of audit committee meetings and financial reporting quality.

2.3.5 System Automation and Staff Competence

The moderating variables in this research are non-audit committee characteristics which have an effect on the relationship between audit committee characteristics and quality of financial reporting. The variables are automation of the accounting process and professional qualifications of accounts staff in non-commercial state corporations. Automation of accounting process enhances financial reporting while having competent staff ensures that proper bookkeeping and recording is done and therefore also enhances quality of financial reporting. Lack of them conversely affects financial reporting in a negative manner.

2.3.6 Quality of Financial Reporting

The potential users of financial reports vary widely and include creditors, suppliers, financial analysts, government authorities and in general, all stakeholders of the entity. The issue of quality in financial reports is of prime concern not only for the final users but for the whole society as it affects economic decisions which may have significant impact (IASB, 2008). Financial reporting is a two party transaction in which the issuers of the financial reports provide them to the users, who use them with the expectation that they will help them enhance their financial decisions. Financial reporting quality is a subtle concept in accounting literature, hence, there is no consensus so far among researchers on how best to define and measure it. McDermott (2011); Biddle, Hilary and Verdi (2009); Nasser and Nuseibeh (2003); Robinson and Munter (2004) define financial reporting quality as the precision with which financial reporting conveys information about the firm's operations or compliance of accounting standards of a particular country, or the extent to which the published financial statements and related disclosures capture the essence of the operations and financial position of the reporting entity.

Jonas and Blanchet (2000) describe two general perspectives that are widely used in the assessment of financial reporting quality. The first perspective relies on the needs of users. Under this perspective, quality of financial reporting is determined on the basis of the usefulness of the financial information to its users, (Baxter 2007). The second perspective of financial reporting quality is focused on the notion of shareholder/investor protection. user needs perspective is mainly concerned with the provision of relevant information to users for making decisions, whereas the shareholder/investor protection perspective aims to ensure that the information

provided to users is sufficient for their needs, transparent and competent, (Jonas & Blanchet 2000).

2.4 Empirical Literature

This section reviewed literature from prior scholars regarding audit committees and quality of financial reporting from various contexts.

2.4.2 Audit Committee Independence and Quality of Financial Reporting

Madakawi (2012) conducted a study on the audit committee characteristics and financial reporting quality in Nigerian listed companies. This study aimed to investigate the effect of audit committee characteristics on the quality of financial reporting of Nigerian listed firms. The study employed multivariate regression analysis with a sample size of 101 and firms-year longitudinal panels of 505 observations of non-financial listed companies on Nigerian Stock Exchange for the period 2010 to 2014. The results showed that control variables; company age and company size are statistically significant. Audit committee share ownership, and financial expertise are positive and statistically significant, indicating that audit committee monitoring mechanisms influence the financial reporting quality of listed nonfinancial firms in Nigeria. Regulatory bodies in Nigeria should mandate all the three board representatives on audit committee to be non-executive directors, while making a combination of financial and industrial expertise replace financial literacy to further improve the quality of the financial reporting. Madakawi (2012) study was conducted on Nigerian listed companies while the current study was conducted in Kenya. The study further focused on share ownership and financial expertise while

the current study focused on independence, diversity, financial competence and meetings in addressing the conceptual gap.

Madawaki and Amran (2013) on the other hand, focused on audit committees and how they affect financial reporting in Nigerian companies. The study examined whether audit committees are associated with improved financial reporting quality for a sample of Nigerian listed companies prior to and after a corporate governance code mandated new regulations for audit committees in 2003. Using a sample of 70 companies listed on the Nigerian Stock Exchange, their study used archival data in the form of companies' annual reports to measure the association between audit committees and improved financial reporting quality. The results indicated that formation of audit committees was positively associated with improved financial reporting quality. It was also found that audit committees having an independent chair and audit committee expertise were positively associated with financial reporting quality. Other audit committee characteristics examined were found to be insignificantly related to financial reporting quality. Madawaki and Amran (2013) study was conducted on listed companies in Nigeria while the current study was conducted in non-commercial state corporations in Kenya. The study further focused on independent chair and audit committee expertise only while the current study included diversity and meetings frequency in addressing the conceptual gap.

Kantudu and Samaila (2015) focused on board characteristics, independent audit committee and financial reporting quality of oil marketing firms in Nigeria. Financial reporting quality was represented by qualitative characteristics of financial statements. Data for the study were obtained from audited annual report and accounts

of the sampled oil marketing companies for twelve years covering 2000 to 2011. Multiple regression was used to analyse the data using Stata version 12.0. It was discovered that power separation, independent directors, managerial shareholdings and independent audit committee are all significant implying monitoring characteristics is influencing financial reporting quality of quoted oil marketing firms in Nigeria. It was recommended that the appointment of independent directors on the companies' board should be based on the previous records of those directors in terms of performance rather than emphasizing on the proportion to total number of directors on the board. Kantudu and Samaila (2015) study focused on board characteristics, independent audit committee and financial reporting quality of oil marketing firms in Nigeria while the current study focused on audit committee characteristics and quality of financial reporting in non-commercial state corporations in Kenya.

Similarly, Hundal (2013) investigated independence, expertise and experience of audit committees. After studying a vast and diverse range of literature pertaining to the audit committees and governance issues, the study made an effort to demonstrate several aspects of independence of audit committee, for example, in formativeness, CEO's power, and frequency of meetings, substitutability and complementarity with alternative corporate governance mechanisms, directors' share ownership and earnings management.

Similarly a wide range of literature based on utility of financial and accounting knowhow and experience of audit committee members was reviewed. An attempt was made to establish association of litigation risk that the firm faced and market

reaction, to the firm's appointment of audit committee members with accounting and financial expertise and experience. This study also included the various aspects of audit committee in India, based on regulations, corporate governance reforms and the limited number of empirical research findings. Lack of independence, expertise and experience of audit committees have rendered them less effective in performing their oversight functions. The study however did not link audit committee characteristics with quality of financial reporting.

Moses, Ofurum and Egbe (2014) studied audit committee characteristics and quality of financial reporting in quoted Nigerian banks. The research was carried out to statistically examine the influence of audit committee characteristics on quality of financial reporting in listed Nigerian banks. The study used financial records from the financial statements of fifteen twelve-monthly reports and accounts of the banks whose stocks are traded in the Nigerian Stock Exchange. The study utilized correlation research design. The test of hypotheses and other breakdown of data were empirically completed by SPSS statistic 22.0. The outcomes of the study depicted that audit committee "independence had no significant effect on earnings management in quoted Nigerian banks. The study endorsed that audit committee should be well-thought-out and operational so as to curtail earnings management.

Moses, Ofurum and Egbe (2014) study focused on commercial banks in Nigeria while the current study focused on non-commercial state corporations in Kenya. The study further employed correlation research design while the current study utilized descriptive research design. The focus of the study was on audit committee

independence while in the current study, the focus was on independence, diversity, financial competence and meetings.

Ghafran (2013) further conducted a study on audit committees and financial reporting quality. The study examined the impact of audit committee characteristics on financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The notion of financial reporting quality was assessed by looking at the audit quality and earnings quality of the firms. This study utilised the audit fee and non-audit fee ratio as its proxies for audit quality and accruals based earnings management models as its proxies for earnings quality. The findings from the multivariate analysis showed that that audit committees meeting three or more times per year and fully independent audit committees exert a significant positive impact on the quality of reported earnings. Ghafran (2013) study focused on the impact of audit committee characteristics on financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya.

2.4.2 Audit Committees Diversity and Quality of Financial Reporting

Gunes and Atilgan (2016) carried out a study on the comparison of the effectiveness of audit committees in the UK and Turkish banks. The study aimed to measure the emphasis of effective audit committees on bank performance using some of the main bank performance indicators which are return on asset (ROA), return on equity (ROE) and net interest margin in the Turkish and the UK banks during 2006-2010. The results revealed that for Turkish banks, both ROA and ROE had negative

association with age of member and independent member of directors. Net interest Margin had negative association with independent member of board of directors and experience in years of member in the audit committee while it had positive association with education level of members. Gunes and Atilgan (2016) study focused on effective audit committees on bank performance in the UK and Turkish banks while the current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya.

Chang, Chen and Zhou (2013) on the other hand focused on the determinants and consequences of audit committee effectiveness with evidence from China. From the corporate governance reports, the study constructed a unique sample to study the determinants and consequences of audit committee effectiveness. The study found that firms with independent director, accounting expertise, more paid supervisors, large chairman ownership, greater total assets, and Big 4 auditors were more likely to have effective audit committees while firms with a significant presence of the largest shareholder and diverse share ownership were less likely to have effective audit committees. Moreover, the study found that firms with effective audit committees were associated with less earnings management and lower audit fees, and were less likely to have modified opinions and delayed filings. Chang, Chen and Zhou (2013) study focused on the determinants and consequences of audit committee effectiveness with evidence from China. The current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya.

Wakaba (2014) similarly investigated the effect of audit committee characteristics on financial performance of companies listed at the Nairobi securities exchange. The research was aimed at establishing the effect of audit committee characteristics on firm performance among listed firms in Nairobi securities exchange, Kenya. The specific objectives of the study were to establish the effect of audit committee size, audit committee gender diversity on firm performance. The study used the agency theory and institutional theory. It adopted an explanatory design and was conducted on firms listed on the Nairobi Securities Exchange for the period ranging from 2006 to 2011. The study thus utilized data from 46 companies as the other 14 companies had either been recently listed or had inconsistently traded in the NSE. Descriptive statistics such as means, standard deviation, frequencies and percentage were used to analyse data. In addition, Multiple Regression was used because of its ability to use multiple independent variables to estimate their effect on a single dependent variable. Research findings showed that audit committee experience, committee gender diversity, audit committee size and number of independent auditors has a significant effect on firm performance. Wakaba (2014) study focused on effect of audit committee characteristics on firm performance among listed firms in Nairobi securities exchange, Kenya. The current study aimed to establish the effect of audit committee characteristics on quality of financial reporting in non-commercial state corporations in Kenya.

Huang, Yan, Fornaro and Elshahat (2011) conducted a study on the market reactions to audit committee director's gender with evidence from US-traded foreign firms. The study hypothesized that female members on the audit committee can strengthen corporate governance by their conservative and ethical qualities. Accordingly, such

appointments delivered a positive message to capital market participants. In order to observe the impact of audit committee gender diversity on foreign firms, the study included all audit committee appointments for US traded foreign firms from 2002 to 2009. The study found that the appointment of female audit committee members had significant positive cumulative abnormal returns compared to the appointment of male audit committee members. Huang, Yan, Fornaro and Elshahat (2011) study was conducted in US-traded foreign firms while the current study focused on effect of audit committee characteristics on quality of financial reporting among non-commercial state corporations in Kenya.

Specific research concerning the effect of gender diversity of audit committee members has recently emerged. Ittonen, Miettinen and Vahamaa (2009) found evidence that firms with female representation on the audit committee reduced the inherent risk of misstatements. Their results have implications for external auditing since they also found that gender diversity is associated with lower audit fees. Huse and Solberg (2006) found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness.

Martinez and Fuentes (2007) studied Spanish companies listed in the stock exchange, which voluntarily formed an audit committee after the Spanish corporate governance code was issued in 1998 (known as the Olivencia Code). The findings of their study might be outlined as follows: ownership concentration affects the possibility of the company receiving a qualified report; the outcome of errors or non-commitment; the presence of the audit committee can never be of the factors related to the company

conservative non-verified report; the presence of an audit committee doesn't reduce the probability of the company receiving a qualified report resulting from errors or non-commitment; and the size and independence of members of the audit committee are variables that have an important statistical impact on the company receiving a qualified report. Martinez and Fuentes (2007) study was done on Spanish companies listed in the stock exchange and focus was on ownership concentration size and independence of members. The current study focused on independence, diversity, financial competence and meetings and was conducted in non-commercial state corporations in Kenya.

2.4.3 Audit Committees Financial Competence and Quality of Financial Reporting

Accounting or financial expertise are attributes, qualification or experience acquired by a person before becoming a board member of a company. Krishnan and Visvanathan (2007) focused on the audit committee characteristics and financial reporting quality. The study employed multivariate regression analysis with a sample size of 125 and firms-year longitudinal panels of 725 observations of non-financial listed companies on Nigerian Stock Exchange for the period 2010 to 2014.

The study adopted McNicholas (2002) model to examine the monitoring mechanisms on the quality of financial reporting. The results showed that control variables; company age and company size are statistically significant. Financial expertise was found to have a positive and statistically significant effect, indicating that audit committee monitoring mechanisms influences the financial reporting quality of listed nonfinancial firms in Nigeria. Krishnan and Visvanathan (2007) main focus was on financial expertise of audit committee while the current study focused on

independence, diversity, financial competence and meetings and was conducted in non-commercial state corporations in Kenya.

Kabiru and Rufai (2014) focused on examination into the quality of audited financial statements of money deposit banks in Nigeria. The study employed the use of both primary and secondary sources of data where questionnaire was the primary source and the annual reports of selected banks were the secondary data. A judgmental sampling technique was used in selecting the sample size. Simple percentage was used for data analysis, while analysis of variance (ANOVA) was employed to test the hypotheses. The study concluded high proportion of financial experts not necessarily accounting experts was unlikely to report weaknesses in the internal control over financial reporting. The study recommended that audit committees of money deposit banks should be more strict in their investigations and should initiate moves for the suing of auditors where they are found wanting.

Kabiru and Rufai (2014) study employed the use of both primary and secondary sources of data where questionnaire was the primary source and the annual reports of selected banks were the secondary data. The current study focused on non-commercial state corporations in Kenya. The study further focused on financial expertise of audit committee and did not include other audit committee characteristics such as independence, diversity and meetings.

Bedard, Chtourou and Courteau (2004) conducted a study on the effect of audit committee expertise, independence, and activity on aggressive earnings management. The study investigated whether expertise, independence, and activities of a firm's audit committee have an effect on the quality of its publicly released financial

information. In particular, the study examined the relationship between audit committee characteristics and the extent of corporate earnings management as measured by the level of income-increasing and income-decreasing abnormal accruals. Using two groups of U.S. firms, one with relatively high and one with relatively low levels of abnormal accruals in the year 1996, the study found a significant association between earnings management and audit committee governance practices. The study further found that aggressive earnings management is negatively associated with the financial and governance expertise of audit committee members, with indicators of independence, and with the presence of a clear mandate defining the responsibilities of the committee. Bedard, Chtourou and Courteau (2004) study focused on expertise, independence, and activities of a firm's audit committee using two groups of U.S. firms. The current study included diversity and meetings to bridge conceptual gap. The current study was further conducted in non-commercial state corporations in Kenya.

McDaniel, Martin and Maines (2002) conducted a study on evaluating financial reporting quality and the effects of financial expertise against financial literacy. They found that experts made better assessment of financial reporting quality compared to non-experts. They concluded that efforts to enhance audit committee financial expertise might influence audit committees' assessment of financial reporting quality. The level of financial knowledge and skill of audit committee members has obvious consequences in dealing with different financial issues. McDaniel, Martin and Maines (2002) evaluated financial reporting quality and the effects of financial expertise against financial literacy while the current study focused on the effects of

audit committee characteristics and quality of financial reporting in non-commercial state corporations in Kenya.

Agung (2015) conducted a study on the impact of certain types of financial expert groups, including accountants and financial brokers performing financial oversight duties. Their study found that the professional accountants are effective in evaluating a firm's compliance with accounting standards and treatments. This implies that the member background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas.

The study of Saleh *et al.* (2007) tried to evaluate the role of some qualities of the audit committee with regard to independence of committee members, its size, its frequency of meetings, and the experience and knowledge members of the committee have to monitor management behaviour. The practices related to earnings management of the general Malaysian joint-stock companies, and the conflict between managers and external auditors, might exist due to the choice of alternative accounting procedures related to earnings management. Some of the most important findings of the study are: absolute independence among members of an audit committee reduces the practices of earnings management in the Malaysian companies; and the companies whose members of audit committees are distinguished for experience, financial knowledge, professionalism, and frequent meetings have less practices of earnings management when compared to other companies.

Zhang, Zhou and Zhou (2007) carried out a study on the audit committee quality, auditor independence, and internal control weaknesses. The study investigated the relationship between audit committee quality, auditor independence, and the disclosure of internal control weaknesses after the enactment of the Sarbanes-Oxley Act. A sample of firms with internal control weaknesses and, based on industry, size, and performance, were matched to a sample of control firms without internal control weaknesses. The conditional logit analyses indicated that a relation exists between audit committee quality, auditor independence, and internal control weaknesses. Firms are more likely to be identified with an internal control weakness, if their audit committees have less financial expertise or, more specifically, have less accounting financial expertise and non-accounting financial expertise.

The study of Carcello, Hollingsworth, Klein and Neal (2006) aimed to establish the relationship between audit committee financial expertise, competing corporate governance mechanisms, and earnings management. The study found that both accounting and certain types of non-accounting financial expertise reduce earnings management for firms with weak alternate corporate governance mechanisms. Importantly, the study found that alternate corporate governance mechanisms are generally an effective substitute for audit committee financial expertise in constraining earnings management. Moreover, the study found evidence that earnings management declines after an accounting financial expert joins the audit committee, suggesting that accounting financial experts are effective monitors of the financial reporting process. Finally, the study found no association between financial expertise and real earnings management. Carcello, Hollingsworth, Klein and Neal (2006) aimed to establish the relationship between audit committee financial

expertise, competing corporate governance mechanisms, and earnings management while the current study focused on the effects of audit committee characteristics on quality of financial reporting in non-commercial state corporations in Kenya.

2.4.4 Conduct of Audit Committee Meetings and Quality of Financial Reporting

The study of Stewart and Munro (2007) from Australia focused on the results of frequency of meetings of the audit committee. They determined that the presence of an audit committee, the number of its meetings and the auditor's attendance for such meetings reduces audit risks, and that the external auditor believes that the presence of an audit committee is an important factor in reducing substantial risks of auditing. They further determined that reducing such risks is also affected by frequent meetings of the audit committee and auditor's attendance of such meetings. Stewart and Munro also found no substantial influence of the audit committee, either on the tests conducted by external auditor or on the time spent by the external auditor and his team in the process of auditing. The audit committee helps in solving disputes and conflicts with the administration and that leads to more improvement in audit quality. However, there is a relationship between the possibility that the company receives qualified reports from the external auditor and the presence of the audit committee characteristics (independence, size, meeting times, and financial experience). Stewart and Munro (2007) study was conducted in Australia and focused on the results of frequency of meetings of the audit committee. The current study was conducted in Kenya and focused on audit committee independence, diversity, financial competence and committee meetings hence addressing both conceptual and geographical gap.

A more recent study by Zájbojníková (2016) sought to establish the relationship between the audit committee characteristics and firm performance. This study analysed the impact of various audit committee characteristics on firm financial performance using the evidence from non-financial UK companies listed on the London Stock Exchange. After recent accounting scandals, the role of the audit committee has come under continuous scrutiny. The main findings of this study suggested that the features of audit committees have an impact on UK firm performance. The findings suggested that there was a significant positive relationship between the audit committee size, frequency of its meetings and its financial experience and firm financial performance. Zájbojníková (2016) analysed the impact of various audit committee characteristics on firm financial performance using the evidence from non-financial UK companies listed on the London Stock Exchange while the current study focused on effects on audit committee characteristics in non-commercial state corporations and quality of financial reporting, therefore addressing the contextual gap.

A study of Saidin (2007) focused on audit committee characteristics and quality of unaudited financial accounts. By using 261 sample companies listed on the Bursa Malaysia in 2004, it was found that 64-percent of companies do have variations in their financial accounts. The occurrences of these variations have raised questions regarding the quality of quarterly accounts produced. The results of the multivariate analysis provide support for the effect of audit committee characteristics on earnings variations, whereby audit committees with greater number of average directorship holdings in other companies and a higher number of members were found to be positively associated with non-variations financial accounts. These results add to the

growing literature on the relationship between audit committee characteristics and financial reporting quality. Saidin (2007) focused on audit committee characteristics and quality of financial accounts using 261 sample companies listed on the Bursa Malaysia in 2004 while the current study focused on effects on audit committee characteristics on non- commercial state corporations and quality of financial reporting, therefore addressing the contextual gap.

Aryan (2015) focused on the relationship between audit committee characteristics, audit firm quality and companies' profitability. This study aimed to highlight the role of audit committee and external audit in enhancing companies' profitability. The study found the need to test these relationships in Jordanian context to provide empirical evidence on this issue, especially after the corporate governance application became mandatory since 2009. The study used industrial sector, which included 91 companies, only 69 companies were included in this study, the other 22 companies were excluded either because they were newly listed or delisted during the study period (2009-2014). Multiple regression was used to analyse the data and the result showed positive relationships between audit committee meeting, audit committee size and companies profitability, while no significant relationship between audit committee composition, audit committee members literacy, audit quality and companies profitability. Aryan (2015) focused on audit committee characteristics, audit firm quality and companies' profitability while the current study focused on effects on audit committee characteristics on non- commercial state corporations and quality of financial reporting in the Kenyan context.

Osarumwense and Aderemi (2016) study focused on the impact of financial literacy and frequency of meetings of members of audit committee on financial reporting quality in Nigerian quoted companies. The main objective of this study was to evaluate the impact of Financial Literacy (FL) and Frequency of Meetings (FM) of members of Audit Committee on financial reporting quality in Nigerian quoted companies. Data for the study was derived from annual reports of one hundred and thirty one (131) companies quoted on the Nigerian Stock Exchange over the period of 2006 to 2012. The data was analyzed using descriptive, correlation and Ordinary Least Square (OLS). The multivariate regression technique was utilized to estimate the model. The findings showed that audit committee financial literacy and audit committee frequency of meetings had a positive significant influence on financial reporting quality. Osarumwense and Aderemi (2016) study focused on evaluating the impact of Financial Literacy (FL) and Frequency of Meetings (FM) of members of Audit Committee on financial reporting quality in Nigerian quoted companies. The current study was conducted in non-commercial state corporations in the Kenyan context.

Zhang and Zhou (2007) used the number of meetings to measure whether the frequency influences quality of financial reporting. The study used the agency theory and institutional theory. This study adopted an explanatory design. Descriptive statistics such as means, standard deviation, frequencies and percentage were used to analyse data. In addition, multiple regression was used because of its ability to use multiple independent variables to estimate their effect on a single dependent variable. The study found a positive correlation. Inactive audit committees with less number of meetings were found to be unlikely to supervise management effectively. The study

further found that fraudulent firms with earnings misstatements have fewer audit committee meetings than non-fraud firms. Zhang and Zhou (2007) used the number of meetings to measure whether the frequency influences quality of financial reporting. The conceptual arguments of this study included audit committee independence, diversity, financial competence and meetings on quality of financial reporting in the Kenyan context.

2.4.5 System Automation, Staff Competence and Quality of Financial Reporting

Mugenda and Mugenda (2012) defines moderating variable as a variable that has an effect on the relationship between the independent and dependent variables, but is not related to or affected by the independent variable. The moderating variables in this research are non-audit committee characteristics which have an effect on the relationship between audit committee characteristics and quality of financial reporting. The variables are automation of the accounting process and professional qualifications of accounts staff in non-commercial state corporations. Automation of accounting process enhances financial reporting while having professional accountants ensures that proper bookkeeping and recording is done and therefore may also enhance quality of financial reporting. Lack of them conversely affects financial reporting in a negative manner.

2.4.6 Quality of Financial Reporting

As a response to the need for improvement and convergence of existing financial reporting frameworks, IASB issued in 2008 an exposure draft titled “An improved conceptual framework for financial reporting”. According to IASB’s conceptual framework a key prerequisite for quality in financial reporting is the adherence to the

objective and the qualitative characteristics of financial reporting information, (IASB, 2008). Qualitative characteristics are the attributes that make financial information useful and comprise of relevance, faithful representation, comparability, verifiability, timeliness and understandability. The primary objective of financial reporting is to provide high-quality financial reporting information concerning economic entities, primarily financial in nature, useful for economic decision making (FASB, 1999; IASB, 2008). This is important because it will positively influence capital providers and other stakeholders in making investment, credit, and similar resource allocation decisions enhancing overall market efficiency (IASB, 2008).

To assess quality of financial reporting, the study used prior literature which defines financial reporting quality in terms of the fundamental and enhancing qualitative characteristics underlying decision usefulness as defined in the exposure draft of IASB. The fundamental qualitative characteristics of relevance and faithful representation are most important and determine the content of financial reporting information. The study used faithful representation as assessed and reported in the external auditor's opinion. Low frequency of unqualified audit opinion was taken to represent faithful representation and therefore quality financial reporting while high frequency of qualified, disclaimer of opinion and adverse opinion was taken to represent non-faithful representation and therefore poor quality financial reporting. Zero ratios of queried transactions to annual budget was interpreted as higher quality of financial reporting as opposed to high ratio of queried transactions to annual budget which was taken as poor financial reporting. The enhancing qualitative characteristics of understandability, comparability, verifiability and timeliness can improve decision usefulness when the fundamental qualitative characteristics are

established. However, they cannot determine financial reporting quality on their own (IASB, 2008).

To faithfully represent economic phenomena that information purports to represent, annual reports must be complete, neutral, and free from material error (IASB, 2008: 36). Economic phenomena represented in the annual report are “economic resources and obligations and the transactions and other events and circumstances that change them” (IASB, 2006: 48). Consistent with prior literature, faithful representation is measured using neutrality, completeness, freedom from material error, and verifiability (Sloan, 2001; Jonas & Blanchet, 2000; Maines & Wahlen, 2006; Gaeremynck & Willekens, 2003; Willekens, 2008).

An annual financial report can never be completely free from bias, since economic phenomena presented in annual reports are frequently measured under conditions of uncertainty. Many estimates and assumptions are included in the annual report. Although complete lack of bias cannot be achieved, a certain level of accuracy is necessary for financial reporting information to be decision useful (IASB, 2008). Therefore, it is important to examine the argumentation provided for the different estimates and assumptions made in the annual report (Jonas & Blanchet, 2000). If valid arguments are provided for the assumptions and estimates made, they are likely to represent the economic phenomena without bias. In addition, valid and well-grounded arguments provided for the accounting principles used increase the likelihood that preparers fully understand the measurement method. This will reduce the possibility of unintentional material errors in their financial report (Jonas & Blanchet, 2000; Maines & Wahlen; 2006). Moreover, when the selected accounting

principles are clearly described and well-founded, it increases the probability to reach consensus and to detect misstatements for the user of the financial report as well as for the auditor. Verifiability implies that different knowledgeable users of financial reporting information reach general consensus, although not necessarily complete agreement” (IASB, 2008).

The other sub notion of faithful representation is neutrality defined as the absence of bias intended to attain a predetermined result or to induce a particular behaviour. Neutral information does not colour the image, it communicates to influence behaviour in a particular direction (IASB, 2008: 37). Jonas and Blanchet (2000) stated that neutrality is about objectivity and balance. Neutrality refers to the intent of the preparer; the preparer should strive for an objective presentation of events rather than focusing solely on the positive events that occur without mentioning negative events

The last construct to measure faithful representation refers to the unqualified auditor’s report. Various researchers examined the impact of an audit and the auditors’ report on the economic value of the firm (Gaeremynck & Willekens, 2003; Kim, Simunic, Stein and Yi, (2007); Willekens, 2008). These researchers concluded that the auditors’ report adds value to financial reporting information by providing reasonable assurance about the degree to which the annual report represents economic phenomena faithfully. Maines and Wahlen (2006) even argue that an unqualified audit report is a necessary condition to perceive the financial reporting information as reliable or faithfully represented.

2.5 Critique of the existing literature

Behavioural methodology may not always be generalizable to large sample studies. However, existing empirical research on audit committee characteristics often proxies audit committee effectiveness with one of its determinants. Typically, audit committee effectiveness is substituted by one of the audit committee characteristics, such as audit committee independence as in researches by Carcello and Neal, 2000; Klein, 2002 or audit committee financial expertise by Krishnan, 2005; Zhang *et al.*, 2007. Use of only some or in the above cases one of the determinant, out of many possible determinants may not give very accurate results.

Some of the researches analyze the relationship between audit committee characteristics and financial reporting quality in extreme circumstances such as financial statement fraud and going-concern reports. For example, Abbott, Parker and Peters (2002) show that financial misstatements are less likely to occur in firms with audit committees that are independent and that have a financial expert. Beasley (1996) showed that the percentage of outside directors on the audit committee is lower for firms that committed financial statement fraud. Carcello and Neal (2000) found a significant, negative relationship between the percentage of affiliated (gray and inside) directors on the audit committee and the likelihood of financially distressed firms receiving a going-concern audit report. However, to give objective results about a phenomenon, it should be investigated while at normal operating state.

The existing research also varies in interpretation of some of the audit committee characteristics. For instance, how do audit committee members interpret the word

‘independence’ in the context of their role which requires not only independence but also objectivity? As reflected by an auditing professional pronouncement, ‘independence’ is an appearance while ‘objectivity’ is a state of mind (The Institute of Internal Auditors, 2005). Qualitative research is capable of identifying the disclosed independent audit committee members in firms’ annual reports, but cannot prove that a presumed independent audit committee member is in fact acting objectively. From the reviewed literature, it is also evident that in different jurisdictions, the meaning of financial expert may vary. This interpretation reduces the comparability of studies on audit committee financial expertise between different countries.

While evaluating personal attributes of audit committee members that may have an effect on their effectiveness in their roles, studies by Huang *et al.* (2011); Goul *et al.* (2011); Joos *et al.* (2003) and Davidson *et al.* (2007); Bedard *et al.* (2004), Liu and Sun (2010) concentrated on age, gender, and ethnicity. However, there are many other attributes that may at a given point in time affect the decision making ability of a person besides the ones studied. Additionally in evaluating expertise of audit committee members, the researches only focused on financial expertise while there are other competencies that assist audit committee members to fulfil their duties. Entities across the world and in Kenya are diversified in many respects - jurisdiction, industries, and scale, as well as their various historical and cultural backgrounds. Therefore focusing on one and making conclusions based on it may be inaccurate as one may require more than just financial expertise.

Generalization of findings whereby a research has been done using a sample and then the results applied on population may lead to wrong conclusions. For instance Lin, Li and Yang (2006) examined the effectiveness of characteristics of audit committees such as size, independence, financial expertise, activity and stock ownership, in line with the recommendations made by the Blue Ribbon Committee in 1999. They tested the year 2000, using 106 publicly-held corporations in the USA. Their dependent variable was reported earnings restatement. Their study evidence suggested no negative association between audit committee expertise and earnings restatements. However the study covered a single year and had a small sample, which makes the generalisation of their findings unreliable.

The audit committee is expected to enhance a firm's financial reporting quality. Financial reporting, however, is influenced by firms' inherent business risks and the controls in place to reduce such risks. Therefore assessing quality of financial reporting without assessing inherent risk may lead to oversimplification of the study phenomena. Therefore researchers for instance, Hirst, Hopkins and Wahlen (2004); Gearemynck and Willekens (2003); Beretta and Bozzolan (2004); Cohen *et al.* (2004) should have focused on all elements in the annual report which include both financial and non-financial information, in order to conclude that financial reporting quality was examined comprehensively. Biddle and Hillary (2006) and Lambert *et al.* (2007) suggest that financial reporting quality is determined from a number of perspectives namely; earning, persistence, timeliness, disclosure quality, audit fee charged, compliance with international financial reporting standards and earning management. These measures of financial reporting quality (FRQ) only focus on attributes believed to influence quality of financial information, hence indirectly

measure the level of FRQ. Going by literature on measures of financial reporting quality there is evidence that some models are not comprehensive measures of reporting quality. Vantendeloo and Vansstrealen (2005) argue that accrual models only use financial information; hence exclude non-financial information from annual reports of firms and this model has been used in most of the empirical studies dealing with FRQ.

2.6 Research gaps

Despite the fact that audit committee characteristics has received a lot of research attention worldwide as evidenced by the literature reviewed, it hasn't been widely researched in Kenya and especially in the public sector. Most of the reviewed researches focused on companies quoted in the stock exchanges of the various countries. Therefore there is need to conduct a research on public sector in Kenya so as to evaluate the effects of audit committee characteristics on quality of financial reporting. This would be interesting since most state corporations are not of commercial nature and therefore there may not be a lot of pressure on the management to show exemplary performance as is the case in companies where shareholders are impressed by superior performance reported in financial statements some of which may be as a result of earnings management.

For instance, Madakawi (2012) study was conducted on Nigerian listed companies while the current study was conducted in Kenya. The study further focused on share ownership and financial expertise while the current study focused on independence, diversity, competence and meetings in addressing the conceptual gap. Madawaki and Amran (2013) study was also conducted on companies in Nigeria while the current

study was conducted in non-commercial state corporations in Kenya. The study further focused on independent chair and audit committee expertise only while the current study included diversity, financial competence and meetings in addressing the conceptual gap

Kantudu and Samaila (2015) study focused on board characteristics, independent audit committee and financial reporting quality of oil marketing firms while the current study focused on audit committee characteristics and quality of financial reporting in non-commercial state corporations. Hundal (2013) study however did not link audit committee characteristics with quality of financial reporting which was conducted in the current study. Moses, Ofurum and Egbe (2014) study focused on commercial banks while the current study focused on non-commercial state corporations. The study further employed correlation research design while the current study utilized descriptive research design. The focus of their study was on audit committee independence while the current study focused on independence, diversity, financial competence and meetings.

Ghafran (2013) study focused on the impact of audit committee characteristics on financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya. Gunes and Atilgan (2016) study focused on effective audit committees on bank performance in the UK and Turkish banks while the current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya.

Chang, Chen and Zhou (2013) study focused on the determinants and consequences of audit committee effectiveness with evidence from China. The current study focused on effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya. Wakaba (2014) study focused on effect of audit committee characteristics on firm performance among listed firms in Nairobi securities exchange, Kenya. The current study aimed to establish the effect of audit committee characteristics on the quality of financial reporting in non-commercial state corporations in Kenya.

Huang, Yan, Fornaro and Elshahat (2011) study was conducted in US-traded foreign firms while the current study focused on non-commercial state corporations in Kenya. Huse and Solberg (2006) found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership.

Martinez and Fuentes (2007) study was done on Spanish companies listed in the stock exchange and focus was on ownership concentration size and independence of members. The current study's focus was on independence, diversity, financial competence and meetings and was conducted in non-commercial state corporations. Krishnan and Visvanathan (2007) main focus was on financial expertise of audit committee while the current study focused on independence, diversity, financial competence and meetings and was conducted in non-commercial state corporations in Kenya.

Kabiru and Rufai (2014) study employed the use of both primary and secondary sources of data where questionnaire was the primary source and the annual reports of selected Banks were the secondary data. The current study focused on non-commercial state corporations. The study further focused on financial expertise of audit committee and did not include other audit committee characteristics such as independence, diversity and frequency of meetings. Bedard, Chtourou and Courteau (2004) study focused on expertise, independence, and activities of a firm's audit committee using two groups of U.S. firms. The current study included diversity and meetings to bridge conceptual gap. The current study was further conducted in non-commercial state corporations in Kenya.

McDaniel, Martin and Maines (2002) evaluated financial reporting quality and the effects of financial expertise against financial literacy while the current study focused on the effects of audit committee characteristics and quality of financial reporting in non-commercial state corporations. Carcello, Hollingsworth, Klein and Neal (2006) aimed to establish the relationship between audit committee financial expertise, competing corporate governance mechanisms, and earnings management while the current study focused on the effects of audit committee characteristics and quality of financial reporting in non-commercial state corporations. Stewart and Munro (2007) was conducted in Australia and focused on the results of frequent meetings on the audit committee. The current study was conducted in Kenya and focused on audit committee independence, diversity, financial competence and meetings hence addressing both conceptual gap and geographical gap.

Zábojníková (2016) analysed the impact of various audit committee characteristics on firm financial performance using the evidence from non-financial UK companies listed on the London Stock Exchange while the current study focused on effects on audit committee characteristics in non-commercial state corporations and quality of financial reporting, therefore addressing the contextual gap. Saidin (2007) focused on audit committee characteristics and quality of unaudited financial accounts using 261 sample companies listed on the Bursa Malaysia in 2004 while the current study focused on effects on audit committee characteristics in non-commercial state corporations and quality of financial reporting, therefore addressing the contextual gap

Aryan (2015) focused on audit committee characteristics, audit firm quality and companies' profitability while the current study focused on effects on audit committee characteristics in non-commercial state corporations and quality of financial reporting in the Kenyan context. Osarumwense and Aderemi (2016) study focused on evaluating the impact of Financial Literacy (FL) and Frequency of Meetings (FM) of members of Audit Committee on financial reporting quality in Nigerian quoted companies. The current study was conducted in non-commercial state corporations in the Kenyan context. Zhang and Zhou (2007) used the number of meetings to measure whether the frequency influences quality of financial reporting. The conceptual argument of this study includes audit committee independence, diversity, financial competence, meetings and quality of financial reporting in the Kenyan context.

2.7 Chapter Conclusion

The above chapter reviewed various theories that explain the relationship between the research variables. Conceptualization of the independent and the dependent variables by analyzing the relationships between the two set of variables was done. Empirical review was conducted where past studies were reviewed and critique advanced on them. Finally research gaps which form the basis of the current research were identified.

The analysis of the empirical literature revealed that studies have been done in this field of quality of financial reporting and audit committees characteristics. However there are still gaps that need to be addressed. The analysis showed that previous studies did not operationalize audit committees characteristics in terms of audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings. Further, the few studies that focused on these variables have reported conflicting findings on the effects of these audit committee characteristics and quality of financial reporting. The analysis of literature further showed little has been done on audit committee characteristics and quality of financial reporting in public sector in Kenya.

The review of theoretical literature also showed that majority of the study in accounting have not conclusively adopted agency theory, stewardship theory, the policeman theory, lending credibility theory, theory of inspired confidence and stakeholder theory in explaining the relationship between audit committees characteristics and quality of financial reporting in non-commercial state corporations in Kenya hence this study sought to address this gap. The study further

identified methodological gaps since very few studies have been done by surveying all the non-commercial state corporations in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this chapter the methodology adopted on data collection and analysis which assisted in achieving the research objectives is outlined and discussed. This chapter covered research philosophy, design, and population, sampling technique, sample size, data collection instruments, pilot test and data analysis.

3.2 Research Philosophy

A research philosophy is a belief about the way in which data about a phenomenon should be gathered, analysed and used. The study adopted a positivism philosophy. Positivists believe that reality is stable and that it can be described from an objective viewpoint, i.e without interfering with the phenomena being studied (Levin, 1998). This philosophy advocates that the phenomena should be isolated and that observations should be repeatable. This involves manipulation of a single independent variable so as to identify regularities in, and to form relationships between the constituent elements of the social world. Predictions can be made on the basis of the observed inter-relationships and conclusions thereby derived.

3.3 Research Design

Descriptive research design was applied in this study. Joseph and David (2006) stated that descriptive research design is useful when the research objectives include determining the degree to which one variable (independent) affect the other variable (dependent). This research design was used by Miringu and Muoria (2011) in their study on Analysis of the effect of Corporate Governance on Performance of

Commercial State Corporations in Kenya and also by Hua-Wei-Huang, (2010) on the study of Audit Committee Characteristics and Corporate Fraud. Upagade and Shende (2013) state that a descriptive survey is mainly concerned with only explaining the facts of a phenomenon without interfering with it. It is a self-report that requires the collection of equitable information from sample (Orodho, 2005). Descriptive survey was also appropriate for this study since it intended to find out what people currently believe in, what they are doing at the moment and so forth (Wood & Baumgartner, 2004).

3.4 Population of the study

A population is defined as the total collection of all the elements about which the study wishes to make some inference (Cooper & Schindler, 2011). The population for this study comprised of all seventy two (72) non-commercial state corporations that existed in Kenya in the financial year 2006 to 2012. Target population consists of all members of a real or hypothetical set of people, events or objects from which a researcher wishes to generalize the results of their research while accessible population consists of all the individuals who realistically could be included in the sample (Orodho, 2003).

This study comprised of seventy two (72) state corporations that existed in 2005 by which time the guidelines on audit committees were effected. It is from this population that the target population was drawn. The respondents comprised head of audit department of the non-commercial state corporations. These categories were chosen because of their expected proximity to confidential information about audit

committee members qualifications and experience as well as general operations of the audit committee.

3.5 Sampling Frame

The sampling frame for the target population was the audit department employees' data base of seventy two state corporations. The non-commercial state corporations are categorized into six (6) sectors.

Table 3.1: Target Population

Category	Population
Regulatory	25
Research Institutes	10
Educational	14
Developmental/Promotional agencies	11
Culture/Social service	10
Revenue collection	2
Total	72

Source: Government of Kenya, Sessional paper 2005, privatization of state corporations and investments.

3.6 Sampling Design

This section describes how the sample size will be determined and the procedure that will be used to identify sample subjects. Kothari and Garg (2014) define sampling design as the technique or procedure the researcher would adopt in selecting items for the sample. Cooper and Schidler (2008) attest that the ultimate test of a sample design is how well it represents the characteristics of the population it purports to represent. Census design was used in the study. This technique was adopted because the population of study was small and the researcher was able to reach all of them within the research period. The study employed census on all the seventy two non-

commercial state corporations. A sample of one (1) employee, the head of internal audit from every non-commercial state corporation was selected to be the respondents

3.7 Sample Size

A sample is a relatively small portion of individuals, which acts as a representative of the entire organization (Mugenda & Mugenda, 2012). The study employed census on all the seventy two non-commercial state corporations. The head of internal audit from every non-commercial state corporation was selected to be the respondents and were issued with a questionnaire to respond to research statements. This was adopted because of the technical and confidential nature of information to be derived from the respondents having in mind that the head of internal audit is usually the secretary to the audit committee.

3.8 Data Collection Instruments

This study examined the effect of audit committee characteristics on quality of financial reporting in non-commercial state corporations in Kenya. For the purposes of achieving the study objectives, two instruments of data collection were employed. Questionnaires were used to obtain primary data of the study variables. The questionnaire was divided into two sections. Section A which captured demographic information of the respondents and sections B to F which drew information from respondents on the effect of audit committee characteristics on financial reporting in non-commercial state corporations in Kenya.

The second instrument was secondary data template which included a summary of the transactions that the auditor queried within that financial year derived from the

audited financial statements of the non-commercial state corporations and the annual report of the Auditor General. Annual budgets for the state corporations were obtained from the Finance Bills of the respective financial years. These two sets of secondary data were used to compute the ratio of queried transactions to annual budget of the state corporation. The two sources of data were fitted into a regression model so as to derive relationships among the study variables.

3.9 Data Collection Procedure

The study used both primary and secondary data. Primary data was collected from direct responses from the employees of the selected state corporations through the use of structured questionnaire. The ratio of queried transactions to annual budget was computed from data on queried transactions and annual budget collected from the audited financial statements and the annual report of the auditor General for the study period as well as the Finance Bill for the respective financial years.

3.10 Pilot Test

A pilot study was carried out to check the validity and reliability of the questionnaires in gathering data required for the study (Saunders, Lewis & Thornhill, 2007). Cooper and Schindler (2011) concur that the purpose of pilot test is to detect weaknesses in design and implementation and to provide proxy for data collection of a probability sample. Baker and Powell (2001) states that the size of a sample to be used for pilot testing varies depending on time, costs and practicality, but the same would tend to be 5- 10 per cent of the main survey. The pilot study questionnaires were therefore administered to eight (8) employees which is equivalent to 11.1% of the population as postulated by Mugenda and Mugenda (2003). Respondents who

participated in the pilot study were not included in the final sample for actual survey. Internal consistency of the research instrument was measured by calculating the Cronbach's alpha.

3.11 Data Processing and Analysis

Descriptive statistics and inferential statistics were employed in data analysis. Descriptive statistics involved the use of frequencies, tables and bar charts were also applied to further show relationships. Since regression analysis is used to quantify the effect of various simultaneous independent variables on a single dependent variable, a multiple linear regression model was used to test the significance of the influence of the independent variables on the dependent variable. Faraway (2002) stated that multivariate linear regression is used in situations where the number of independent variables is more than one.

The primary data was collected through questionnaires while secondary data was gathered from the audited financial statements and annual reports of the selected state corporations as well as finance bills and reconciled in tabular forms for meaningful analysis and interpretation. Data collected from both primary and secondary sources were analysed with the aid of descriptive statistical techniques such as percentages, frequencies, tables and bar charts. Inferential statistics such as correlation coefficients and regression analysis were used in the analysis. This was useful to prove the level of significance in testing the stated hypotheses. The tests conducted were normality, linearity, homogeneity, heteroskedasticity and autocorrelation to ensure the best linear estimate of the model was achieved.

According to Judd, Kenny and McClelland (2001) moderation implies an interaction effect, where introducing a moderating variable changes the direction or magnitude of the relationship between two variables. In a linear causal relationship in which the variable X is presumed to cause the variable Y, a moderator variable Z is a variable that alters the strength of the causal relationship. A moderation effect could be (a) Enhancing, where increasing the moderator would increase the effect of the predictor on the outcome; (b) Buffering, where increasing the moderator would decrease the effect of the predictor on the outcome; or (c) Antagonistic, where increasing the moderator would reverse the effect of the predictor on the outcome. To test moderation, the study looked at the interaction effect between X and Z and whether or not such an effect is significant in predicting Y.

3.11.1 Model Specification

With ordinary least square (OLS) simple and multiple regression analyses, the study assessed the effects of independent variables on the dependent variable. The models are stated as follows:

Model 1 – Effect of Audit Committee Independence on Quality of Financial Reporting in non-commercial state corporations in Kenya.

$$QFR = \beta_0 + \beta_1(ACI) + e \dots\dots\dots 3.1$$

Where:

QFR = Quality of Financial Reporting

ACI = Audit Committee Independence

β_0 = Model intercept

β_1 = The beta coefficient of Audit Committee Independence.

e = Error term of the model.

Model 2 – Effect of Audit Committee Diversity on Quality of Financial Reporting in non-commercial state corporations in Kenya.

$$QFR = \beta_0 + \beta_1 (ACD) + e \dots\dots\dots 3.2$$

Where:

QFR = Quality of Financial Reporting

ACD = Audit Committee Diversity

β_0 = Model intercept

β_1 = The beta coefficient of Audit Committee Diversity.

e = Error term of the model.

Model 3 – Effect of Audit Committee Financial Competence on Quality of Financial Reporting in non-commercial state corporations in Kenya.

$$QFR = \beta_0 + \beta_1 (ACFC) + e \dots\dots\dots 3.3$$

Where:

QFR = Quality of Financial Reporting

ACFC = Audit Committee Financial Competence.

β_0 = Model intercept

β_1 = The beta coefficient of Audit Committee Financial Competence.

e = Error term of the model.

Model 4 – Effect of Conduct of Audit Committee Meetings on Quality of Financial Reporting in non-commercial state corporations in Kenya.

$$QFR = \beta_0 + \beta_1 (ACM) + e \dots\dots\dots 3.4$$

Where:

QFR = Quality of Financial Reporting

ACM = Conduct of Audit Committee Meetings.

β_0 = Model intercept

β_1 = The beta coefficient of Audit Committee Meetings.

e = Error term of the model.

Model 5 – The general model stating the effect of Audit Committees on Quality of Financial Reporting in non-commercial state corporations in Kenya.

$$QFR = \beta_0 + \beta_1 ACI + \beta_2 ACD + \beta_3 ACFC + \beta_4 ACM + e \dots \dots \dots 3.5$$

Where:

QFR = the value of the dependent variable depicting quality of financial reporting

β_0 = Model intercept

{ β_i ; $i=1,2,3,4$ } = Coefficients for the independent variables ACI, ACD, ACFC, ACM

ACI = Audit committee Independence

ACD = Audit Committee Diversity

ACFC = Audit Committee Financial Competence.

ACM = Conduct of Audit Committee Meetings.

e is the error term which is assumed to be normally distributed with mean zero and constant variance.

Model 6: The moderating effect of non – audit committee variables on Quality of Financial Reporting in non-commercial state corporations in Kenya

$$QFR = \beta_0 + \beta_1 ACI + \beta_2 ACD + \beta_3 ACFC + \beta_4 ACM + \beta_5 (Z) + e \dots \dots \dots 3.6$$

Where:

QFR = Quality of Financial Reporting

ACI = Audit committee Independence

ACD = Diversity of audit committee

ACFC = Financial competence of audit committee members

ACM = Conduct of Audit committee Meetings

Z= Moderating variable

β_0 = Model intercept { β_i ; $i=1,2,3,4$ } = Coefficients for the independent variables

ACI, ACD, ACFC, ACM with moderating effect.

β_5 = The beta coefficient of the moderating variable

The model was tested on how well it fitted the data and at the same time the significance of each independent variable was tested using Fischer distribution test, F-test at 95% confidence level. F-test depicted the ratio between the mean square of the model divided by the error mean square. The p-value for the F-statistic was applied in determining the robustness of the model. The conclusion was based on the basis of p value where if the null hypothesis of the beta is rejected then the overall model was significant and if null hypothesis is not rejected the overall model was insignificant. In other words if the p-value was less than 0.05 then it was concluded that the model was significant and has good predictors of the dependent variable and that the results are not based on chance. If the p-value was greater than 0.05 then the model was not significant and cannot be used to explain the variations in the dependent variable. Correlation between the variables was tested. The test of the goodness of fit of the model was obtained for model summary which determined the coefficient of determination, R- square which measured the proportion or percentage of the total variation in the dependent variable explained by the independent variables.

3.11.2 Operationalization of Variables

Table 3.2 contains variables category, operationalisation, and scale of measurement and methods of analysis adopted to test the hypothesis.

Table 3.2: Operationalization of Variables

Category of Variable	Variable	Operationalization	Scale of Measurement	Methods of Analysis
Dependent	Quality of Financial Reporting	<ul style="list-style-type: none"> ✓ Value of queried transactions. ✓ Annual budgets. ✓ Ratio of queried transactions/total budget 	Ratio	Descriptive statistics
Independent	Audit Committee Independence	<ul style="list-style-type: none"> ✓ Presence of Non-Executive Members ✓ Selection of Chairman ✓ Appointment of Members ✓ Relationship with top management 	Nominal scale	Descriptive and inferential analysis <ul style="list-style-type: none"> • Correlation • Regression analysis
	Audit Committee Diversity	<ul style="list-style-type: none"> ✓ Age Diversity ✓ Regional Diversity ✓ Tenure Diversity ✓ Gender Diversity 	Nominal scale	Descriptive and inferential analysis <ul style="list-style-type: none"> • Correlation • Regression analysis
	Audit Committee financial competence	<ul style="list-style-type: none"> ✓ Financial Training ✓ Knowledge in Accounting Matters ✓ Experience in Audit ✓ Knowledge in Risk Management 	Nominal scale	Descriptive and inferential analysis <ul style="list-style-type: none"> • Correlation • Regression analysis
	Audit Committee meetings	<ul style="list-style-type: none"> ✓ Meeting Frequency ✓ Number of Meetings ✓ Relevance of Agenda ✓ Attendance of meetings 	Nominal scale	Descriptive and inferential analysis <ul style="list-style-type: none"> • Correlation • Regression analysis
Moderating	System automation and staff competences	<ul style="list-style-type: none"> ✓ Professional qualifications of Accountants ✓ Continuous Professional Training of Accountants ✓ Level of automation ✓ Proper and modern book-keeping system. 	Nominal scale	Descriptive and inferential analysis <ul style="list-style-type: none"> • Correlation • Regression analysis

3.12 Diagnostics Tests

Since the research will utilize multiple regression equations, the data will first be checked for violations of assumptions and help to form requisite analysis and include, autocorrelation, normality test, multicollinearity and heteroscedasticity

3.12.1 Testing for Multicollinearity

Multicollinearity is a phenomenon where there is inter-correlation among the explanatory variables. Runkle, DeFusco, Anson, Pinto and McLeavey (2013) posit that, multicollinearity occurs in statistics where two or more predictor variables in a multiple regression are highly correlated. The variables or items should be reasonably correlated to each other but not to the point of extreme multicollinearity or correlations greater than 0.90 (Tabachnick & Fidell, 1996).

Multicollinearity is an unacceptable high level of inter correlation among the independent variables, such that effects of independent variables cannot be separated (Garson, 2012). In multiple regression, the variance inflation factor (VIF) is used as an indicator of multicollinearity. Variance inflation factor (VIF) is a factor by which the variance of the given partial regression coefficient increases due to given variable's extent of correlation with other predictors in the model (Dennis, 2011). As a rule of thumb, lower levels of variance inflation factor (VIF) are desirable as higher levels of VIF are known to affect adversely the results associated with multiple regression analysis. A simple diagnostic of co linearity is the variance inflation factor for each regression coefficient (Fox, 1991). This study adopted a VIF value of 4.0 as the threshold

3.12.2 Test for Normality

The assumption of linear regression requires that the data should be normally distributed. Therefore to test the normality of the dependent variable, Ratio of Queried Transactions to Annual Budget, a One-Sample Kolmogorov-Smirnov Test (KS) was conducted. The Kolmogorov-Smirnov test (also known as the K-S test or one sample Kolmogorov-Smirnov test) is a non-parametric procedure that determines whether a sample of data comes from a specific distribution, i.e., normal, uniform, Poisson, or exponential distribution. It is mostly used for evaluating the assumption of univariate normality by taking the observed cumulative distribution of scores and comparing them to the theoretical cumulative distribution for a normally distributed variable. The null and alternative hypotheses are stated below.

H_0 : The data is normally distributed

H_1 : The data is not normally distributed

The rule is that if the p-value is greater than 0.05, H_0 is accepted and H_1 is rejected, if the p-value is less than 0.05, H_0 is rejected and H_1 is accepted

3.12.3 Factor Analysis

The broad purpose of factor analysis is to summarize data so that relationships and patterns can be easily interpreted and understood. The two main factor analysis techniques are Exploratory Factor Analysis (EFA) and Confirmatory Factor Analysis (CFA). CFA attempts to confirm hypotheses and uses path analysis diagrams to represent variables and factors, whereas EFA tries to uncover complex patterns by exploring the dataset and testing predictions (Pearce & Yong, 2013). Exploratory Factor Analysis will be applied where components will be extracted using principal

component analysis. EFA seeks the least number of factors which can account for the common variance (correlation) of a set of variables (Child, 2008).

By a rule of thumb in confirmatory factor analysis, loadings should be 0.7 or higher to confirm that independent variables identified a priori are represented by a particular factor, on the rationale that the 0.7 level corresponds to about half of the variance in the indicator being explained by the factor (Hair, Black & Babin, 2010, Kothari, 2009). While it is generally agreed that loadings from factor analysis 0.7 and above are preferable for analysis, Rahim and Magner (2008) explains that researchers use 0.4 given that 0.7 can be high for real life data to meet this threshold.

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.1 Introduction

This section presented data analysis, results presentation and discussion of the findings. The chapter contains the descriptive results, correlation results and regression results testing all the study objectives. The chapter further presented the findings of hypotheses testing based on data analysis.

4.2 Response Rate

A total number of 72 questionnaires were administered to the heads of audit departments in non-commercial state corporations in Kenya. A response rate of 46 was recorded. This constituted 63.89% response rate. Response rate refers to the extent to which the final data set includes all sample members and is calculated as the number of people with whom interviews are completed divided by the total number of people in the entire sample, including those who refused to participate and those who were unavailable, (Fowler, 2004). According to Mugenda and Mugenda (2003), a response rate of more than 50% is adequate for analysis. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good. The achieved response rate was good. The response rate of 63.89% could be attributed to the personal efforts of the researcher in administering the questionnaires and a close follow up with the respondents.

4.3 Reliability Test Results

Before actual collection of data, a reliability testing was conducted to obtain some assessment of the questions' validity and the likely reliability of the data. Pre-testing

was done and questionnaires issued to respondents which were randomly sampled. The questionnaires were then analysed to establish the reliability and validity of the research instrument.

4.3.1 Validity Test Results

To ensure content validity, the researcher did a thorough review of literature and identified items that were to measure the concepts, and to further ensure that the questions covered all areas of the study. Validity was also checked by the supervisor who went through the questionnaire to ensure it was free from ambiguity. This enabled the researcher to assess validity of instrument including clarity, relevance, and interpretation of questions and if the respondents could answer all the questions without difficulties.

4.3.2 Reliability Test Results

Various scholars view reliability as the repeatability, stability or internal consistency of a questionnaire (Bryman, 2008; Cooper & Schindler, 2011; McMillan & Schumacher, 2010). Reliability is an indication of the stability and consistency with which the instrument measures a concept and helps to assess the goodness of a measure. In this study, Cronbach's Alpha, which is a reliability coefficient, was used to indicate how well the items in the set were correlated with each other. According to Sekara, (2008) the closer a Cronbach's Alpha is to 1 the higher the reliability and a value of at least 0.7 is recommended. The cronbach's alpha was used in this study to measure the internal consistency of the variables. The study consists of four independent variables and one dependent variable. The independent variables consist of audit committee independence, audit committee diversity, audit committee

financial competence and audit committee meetings. The reliability of the variables and the results are shown in Table 4.1.

Table 4.1: Reliability Test Results

Variables	Cronbach's alpha	Number of Items	Comment
Audit Committee Independence	0.723	4	Accepted
Audit Committee Diversity	0.911	4	Accepted
Financial Competence	0.841	4	Accepted
Audit Committee Meetings	0.878	4	Accepted
Quality Of Financial Reporting	0.772	4	Accepted
Automation & qualification	0.712	4	Accepted

4.4 Respondents Background information

The respondents were supposed to indicate their background information. The background information sought included education level, respondent's work experience and professional qualification. The information was intended to ascertain the credibility of the respondents to provide the information necessary for this study.

4.4.1 Education Level of Respondents

The study sought to establish the level of education of the respondents. The findings are provided in the figure 4.1 below.

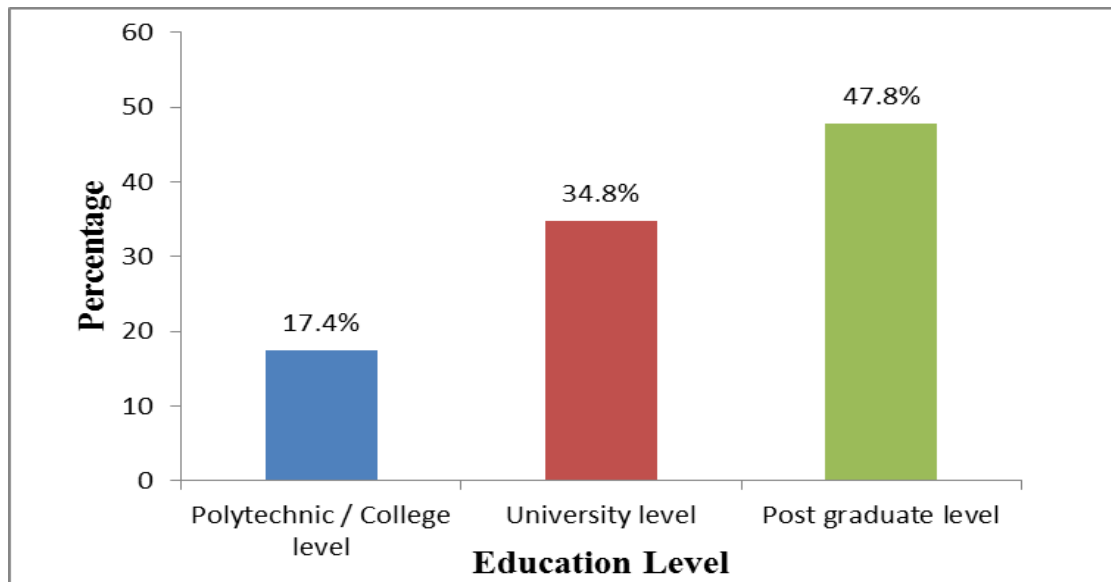


Figure 4.1: Education Level of Respondents

The results indicated that majority (47.8%) of the respondents had post graduate level of education while those who had university level were 34.8% and finally those with polytechnic/college level were 17.4%. This shows that they could interpret the questions in the questionnaires well and respond accordingly. This enhanced the reliability of the data collected. These finding implied that the respondents in this study had the pre-requisite academic qualifications and this could be one of the reasons they held top management positions in their respective state corporations. An individual's level of education is attributed to his level of competence and his ability to meet professional demands of top management positions. This proposition is supported by Raymond (2008), who posited that professionalism in any occupation relates not only to the levels of education and qualifications of the workforce but also to the professional approach in the conduct of business activities.

4.4.2 Number of Years Worked by the Respondents in non-commercial state corporations.

The study sought to find out the number of years the respondents had worked in the non-commercial state corporations. The results are presented in the figure 4.2. The study findings show that (22%) of the respondents had worked for between 3 and 5 years while 77.7% had worked for over 5 years. Those who had worked for less than 2 years were 0.3%. This level of experience was appropriate for the study because majority of the respondents had understanding of auditing operations. The respondents of this study included the heads of internal audit that were privy to the detailed and confidential information about audit committee members by the virtue of being the secretary to the committee.

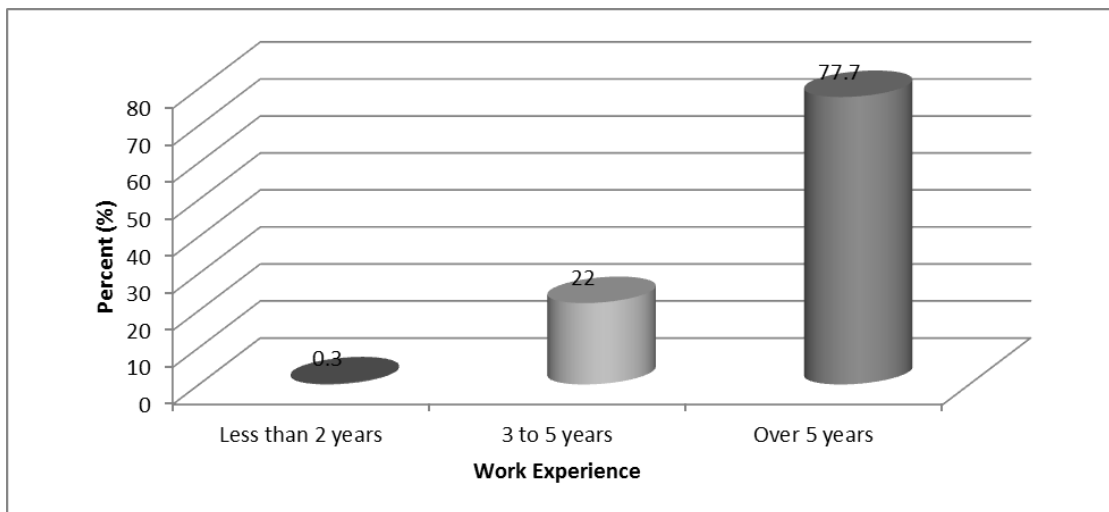


Figure 4.2: Number of Years Worked by the Respondents in non-commercial state corporations.

4.5 Factor Analysis

Factor analysis was conducted for the independent, moderating and dependent variables to find the strength of observed variables in order to reduce the number of variables, if necessary. The importance of conducting factor analysis was to summarize the information contained in a number of original variables into a smaller number of factors without losing much information. This implies that the newly created variables should represent the fundamental constructs, which underlie the original variables (Gorsuch, 1990). Factor loadings represent how much a factor explains a variable in factor analysis. The general rule of the thumb for acceptable factor loading is 0.40 or above (David, Patrick, Phillip & Kent, 2010).

Cooper and Schindler (2008) have indicated 0.7 to be an acceptable loading. Other researchers suggest that 0.4 is the minimum level for item loading. Hair *et. al.*, (2010) highlighted that factor analysis is necessary in research to test for construct validity and highlight variability among observed variables and to also check for any correlated variables in order to reduce redundancy in data. The summary of the factor analysis for all the variables are stated in Table 4.2, 4.3, 4.4, 4.5 and Table 4.6. The results for the audit committee independence subcontracts, audit committee diversity subcontracts, financial competence subcontracts and audit committee meetings subcontracts showed that all the factor loadings for the five items were above 50%.

Table 4.2: Factor Analysis for Audit Committee Independence Subcontracts

Subcomponents	Factor	
	Loadings	Comment
Presence of non-executive members.	0.79	Accepted
Transparency in selection of chairman.	0.741	Accepted
Transparency in appointment of members.	0.783	Accepted
Members' relationship with top management.	0.707	Accepted

Extraction Method: Principal Component Analysis.

All the subcontracts for audit committee independence were accepted based on the general rule of thumb for acceptable factor loading of above 0.40. No item was removed or dropped. The findings showed that subcontracts had factor loadings of above 0.71 implying that the newly created variables represented the fundamental constructs which underlie the original variables. Costello and Osborne (2005) argue that if an item has loading of less than 0.4 it may either not be related to the other items or suggests an additional factor that should be explored. Mwiti (2013) suggested that variables with factor loadings greater than 0.3 were the ones that had the highest significance and influence.

Table 4.3: Factor Analysis for Audit Committee Diversity Subcontracts

Component	Factor Loadings	Comment
Age Diversity	0.613	accepted
Regional Diversity	0.723	accepted
Tenure Diversity	0.866	accepted
Gender Diversity	0.629	accepted

Extraction Method: Principal Component Analysis.

Similarly, all the subcontracts for audit committee diversity were accepted based on the same rule of thumb for acceptable factor loading of 0.40 and above. No item was removed or dropped. The findings showed that subcontracts had factor loadings of above 0.61 implying that the newly created variables represented the fundamental constructs which underlie the original variables. Costello and Osborne (2005) argue that if an item has loading of less than 0.4 it may either not be related to the other items or suggests an additional factor that should be explored.

Table 4.4: Factor Analysis for Audit Committee Financial Competence Subcontracts

Component	Factor Loadings	Comment
Committee members' financial training.	0.801	Accepted
Committee members' knowledge in Accounting matters.	0.806	Accepted
Audit committee members experience in Financial reporting and audit related fields.	0.861	Accepted
Audit committee members' knowledge of governance and risk management.	0.565	Accepted

Extraction Method: Principal Component Analysis.

All the subcontracts for audit committee financial competence were accepted based on the same rule of thumb for acceptable factor loading of 0.40 and above. No item was removed or dropped. The findings showed that subcontracts had factor loadings of above 0.56 which means that the newly created variables represented the fundamental constructs which underlie the original variables. Rahim and Magner (2008) explains that researchers use 0.4 given that 0.7 can be high for real life data to meet this threshold

Table 4.5: Factor Analysis for Conduct of Audit Committee Meetings Subcontracts

Component	Factor Loadings	Comment
Meetings frequency.	0.804	Accepted
Adequacy of meetings held by the audit committee	0.746	Accepted
Relevance of agenda of audit committee meetings.	0.774	Accepted
Attendance of meetings.	0.622	Accepted

Extraction Method: Principal Component Analysis.

All the subcontracts for audit committee meetings were accepted based on the same rule of thumb for acceptable factor loading of 0.40 and above. No item was removed or dropped. The findings showed that subcontracts had factor loadings of above 0.62 implying that the newly created variables represented the fundamental constructs which underlie the original variables. Rahim and Magner (2008) explains that researchers use 0.4 given that 0.7 can be high for real life data to meet this threshold

Table 4.6: Factor Analysis for Automation & Qualifications Subcontracts

Component	Factor	
	Loadings	Comment
Presence of qualified accountants	0.643	Accepted
Continuous professional training of Accountants	0.780	Accepted
Level of automation of accounting process	0.806	Accepted
Proper and modern book-keeping system	0.738	Accepted

Extraction Method: Principal Component Analysis.

All the subcontracts for system automation and staff competences were accepted based on the same rule of thumb for acceptable factor loading of 0.40 and above. No item was removed or dropped. The findings showed that subcontracts had factor loadings of above 0.64 which means that the newly created variables represented the fundamental constructs which underlie the original variables. Factor analysis looks at the internal-correlations among data to come up with internally consistent surrogates of the variable (Mugenda, 2010). These correlations helped the researcher to formulate an interpretation of the components (variables). Hair *et. al.*, (2010) highlighted that Factor Analysis was necessary in research to test for construct validity and highlight variability among observed variables and to also check for any correlated variables in order to reduce redundancy in data.

4.6 Diagnostic Tests Results

When the assumptions of the linear regression model are correct, ordinary least square (OLS) provides efficient and unbiased estimates of the parameters (Long & Ervin, 2000). As Pedhazur (1997) noted that knowledge and understanding of the situations when violations of assumptions lead to serious biases, and when they are

of little consequence, are essential to meaningful data analysis. To keep up with the assumptions, this study conducted the following diagnostic tests: reliability test, normality test, homoscedasticity test and multicollinearity test on the variables. However, as Osborne, Christensen, and Gunter (2001) observe, few articles report having tested assumptions of the statistical tests they rely on for drawing their conclusions.

4.6.1 Normality Test

The assumption of linear regression requires that the data should be normally distributed. Therefore to test the normality of the dependent variable, Ratio of Queried Transactions to Annual Budget, a One-Sample Kolmogorov-Smirnov Test (KS) was conducted. The Kolmogorov-Smirnov test (also known as the K-S test or one sample Kolmogorov-Smirnov test) is a non-parametric procedure that determines whether a sample of data comes from a specific distribution, i.e., normal, uniform, Poisson, or exponential distribution. It is mostly used for evaluating the assumption of univariate normality by taking the observed cumulative distribution of scores and comparing them to the theoretical cumulative distribution for a normally distributed variable. The null and alternative hypotheses are stated below.

H_0 : The data is normally distributed

H_1 : The data is not normally distributed

The rule is that if the p-value is greater than 0.05, H_0 is accepted and H_1 is rejected, if the p -value is less than 0.05, H_0 is rejected and H_1 is accepted.

Table 4.7: One-Sample Kolmogorov-Smirnov Test

		Ratio Queried Transactions to Annual Budget	AC Independence	AC Diversity	AC Financial Competence	AC Meetings	Automation & Qualification
N		46	46	46	46	46	46
Normal Parameter s a,b	Mean	1.232139	3.2043	4.1141	4.0163	4	4.0054
	Std. Deviation	3.22507	0.5473	0.7865	0.84558	0.8724	0.83747
Most Extreme Difference s	Absolute	0.351	0.2	0.308	0.253	0.221	0.332
	Positive	0.348	0.095	0.144	0.128	0.13	0.187
	Negative	-0.351	-0.2	-0.308	-0.253	-0.221	-0.332
Kolmogorov-Smirnov Z		0.382	0.356	0.087	0.717	0.502	0.253
Asymp. Sig. (2-tailed)		0.621	0.051	0.213	0.057	0.222	0.231

a Test distribution is Normal.

b Calculated from data.

The results obtained indicate that Kolmogorov-Smirnov Z statistic for all the variables was greater than 0.05, the null hypothesis was accepted and concluded that the data for all the variables was normally distributed and therefore fit for linear regression analysis.

4.6.2 Test for Multicollinearity

Multicollinearity is an unacceptable high level of inter correlation among the independent variables, such that effects of independent variables cannot be separated (Garson, 2012). In multiple regression, the variance inflation factor (VIF) is used as an indicator of multicollinearity. Variance inflation factor (VIF) is a factor by which the variance of the given partial regression coefficient increases due to given variable's extent of correlation with other predictors in the model (Dennis, 2011). As

a rule of thumb, lower levels of variance inflation factor (VIF) are desirable as higher levels of VIF are known to affect adversely the results associated with multiple regression analysis. A simple diagnostic of co linearity is the variance inflation factor for each regression coefficient (Fox, 1991).

This study adopted a VIF value of 4.0 as the threshold. Audit committee Independence had a VIF of 1.308, Audit Committee Diversity 2.562, Audit Committee Financial Competence 2.72, Audit Committee Meetings, 2.713 and System automation and staff competence 2.924. These results indicate that the VIF values of the independent variables were within the threshold of 4.0. This indicated that there was no significant threat of multicollinearity problem and therefore, the study used linear regression model. The results of the analysis are shown in Table 4.8.

Table 4.8: Multicollinearity Test

Variables	Tolerance	VIF
Audit committee Independence	0.765	1.308
Audit committee Diversity	0.39	2.562
Audit committee Financial Competence	0.368	2.72
Audit committee Meetings	0.369	2.713
System automation and staff competences	0.342	2.924

4.7 Trends Analysis

4.7.1 Trend in Annual Budget

The results of trends analysis revealed that annual budget of non-commercial state corporations in Kenya increased from 2007 to 2012. The responsibility and mandate of the state corporations have been increasing from 2007 and this could explain why the annual budgets have been increasing. Cornell and D'Arcy (2014) also noted that State corporations account for a sizable, and growing, share of Kenya's budget, and perform functions that span the national, regional, and county levels. This is due to large expenditures from the non-commercial and commercial parastatals sectors, combined with a small amount of spending from the local authorities.

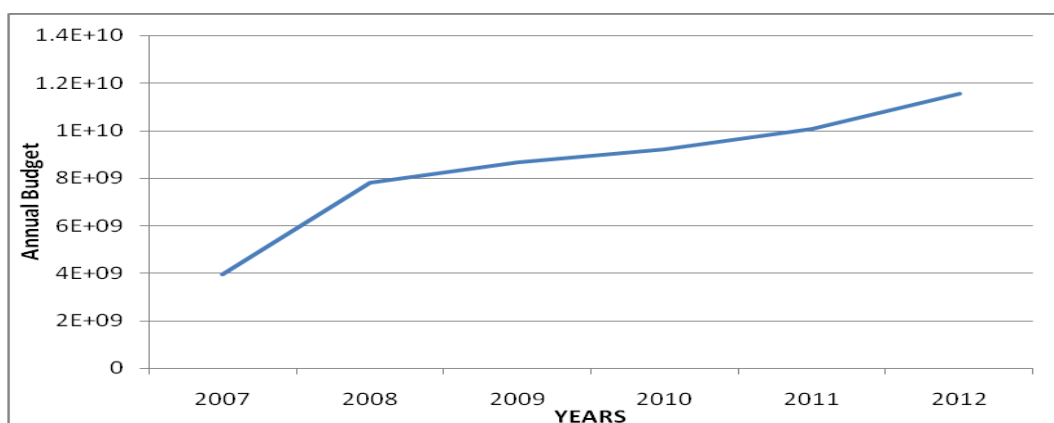


Figure 4.3 Trends in Annual Budget of non-commercial state corporations

4.7.2 Trend in Value of Queried Transactions (Kshs)

The study sought to establish the trend in value of queried transactions in non-commercial state corporations in Kenya. The results of trend analysis revealed that value of queried transactions increased from 2007 to 2009. From 2009 the value of queried transactions started decreasing up to 2011 before increasing to 2012. The increases in the value of queried transaction indicate that there has been low quality

financial reporting in the state corporations. A report by International Monetary Fund (IMF), (2016) showed that the quality of reporting is diminished by the existence of different estimates of actual fiscal outcomes that are not internally consistent with verifiable information, such as the stock of debt. The integrity of reporting is weak, with no consolidated financial statement and almost half of expenditure being subject to adverse or disclaimer audit opinions (Bastida & Benito, 2007).

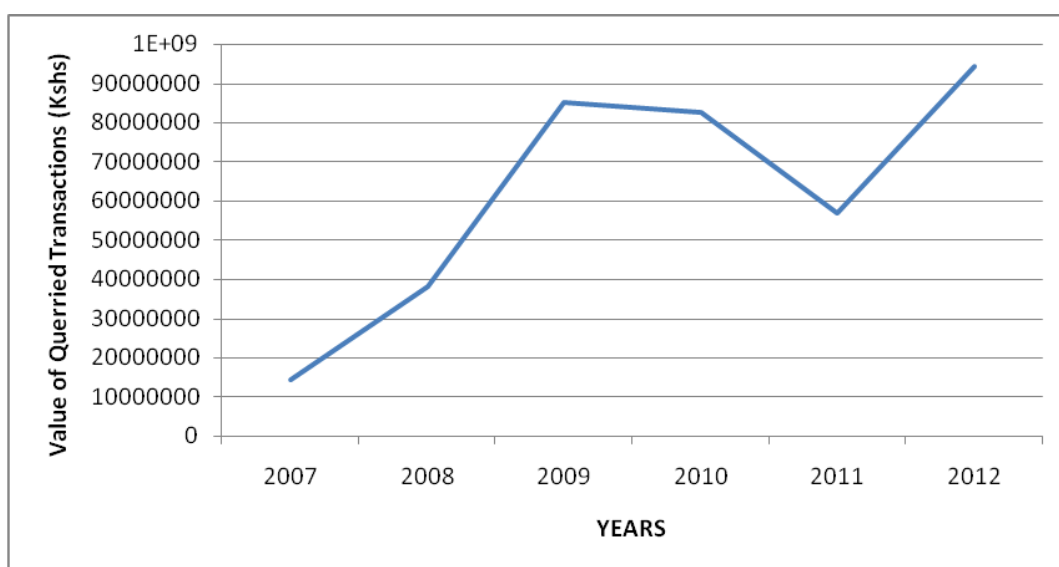


Figure 4.4 Trends in Value of Querried Transactions (Kshs)

4.7.3 Trend in Ratio of Querried Transactions to Annual Budget

The study further sought to analyse the trends in the ratio of queried transactions to annual budget in non-commercial state corporations in Kenya. The results of trend analysis showed that Ratio of Querried Transactions to Annual Budget decreased from 2007 to 2008 before increasing to 2010. From 2010 to 2011 the Ratio of Querried Transactions to Annual Budget was constant before increasing to 2012. The result implied that increases in the annual budget for state corporations corresponded to the increase in the ratio of queried transactions to annual budget. Mutiso and

Kamau (2013) findings revealed that a number of variables contribute to complexity in preparation of statements of organisations. Management interference was a major contributor to low quality financial reporting among state corporations.

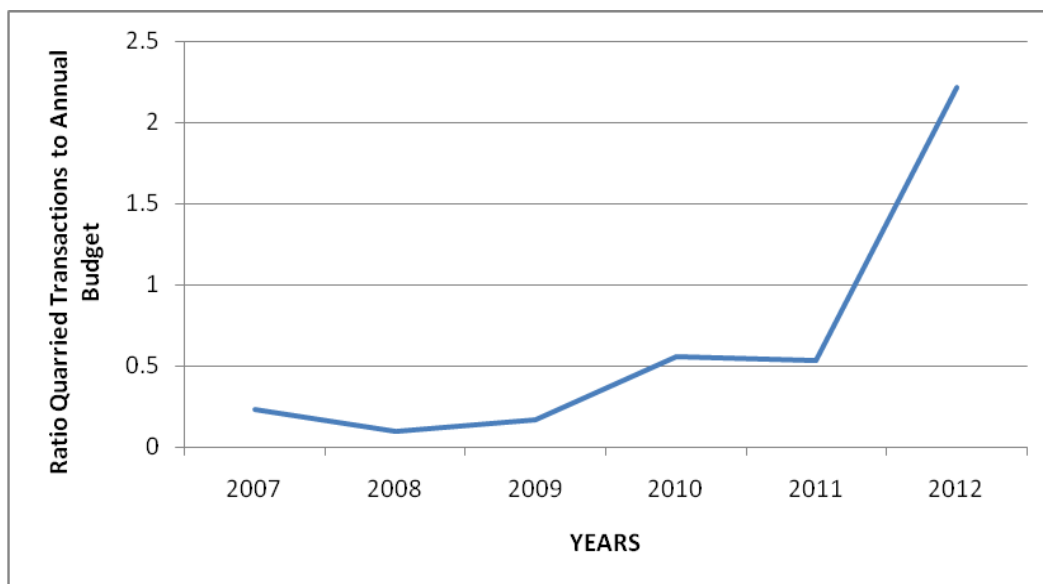


Figure 4.5 Trends in Ratio of Queried Transactions to Annual Budget

4.7.4 Trend in Total Audit Committee Members

The study was further interested in the trend of audit committee membership numbers in non-commercial state corporations from 2007 to 2012 in Kenya. The result of trend analysis revealed that the total audit committee members in non-commercial state corporations in Kenya had been increasing from 2007 to 2008 before remaining constant between 2008 and 2009. From 2009 to 2012 the audit committee members decreased. The study by ICPAK (2015) established that the size of Audit Committees in state corporations was between three (3) and seven (7) members. Forty eight percent (48%) of the respondents indicated a membership of five (5) in their committees.

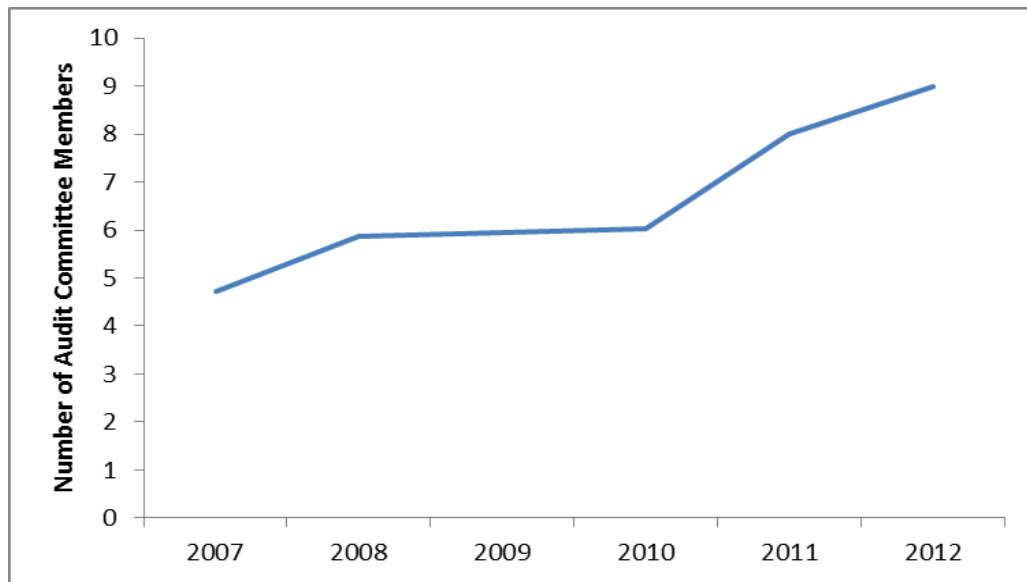


Figure 4.6 Trends in total audit committee members

4.7.5 Trend in numbers of non-executive members in audit committees in state corporations.

The study also analysed trend in numbers of non-executive members in Audit committees in non-commercial state corporations. Trend analysis results showed that 2007 had the highest number of non-executive members of audit committee in non-commercial state corporations in Kenya. The numbers dropped in 2008 before increasing up to 2010. Between 2011 and 2012 the number slightly remained constant. An important contributor to this was the American Institute of Certified Public Accountants (AICPA), who issued a policy statement encouraging public companies to establish AC's composed entirely of a membership outside the directors. Chatfield and Vangermeersch (2014) argued that the Audit Committee members should have a Chairman among them who is an independent non-executive director and that the chairman should not be the chairperson of the board but could be invited to attend meetings as necessary by the chairperson of that committee.

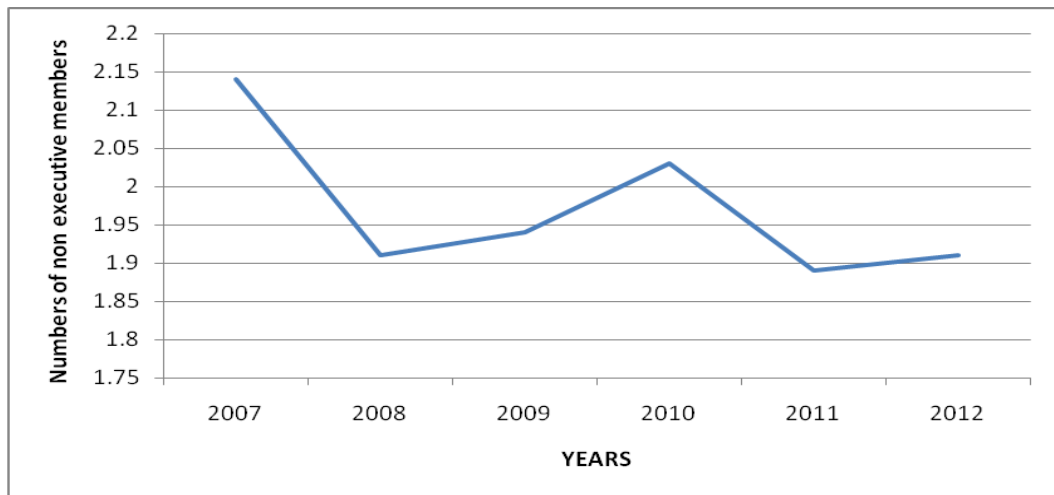


Figure 4.7 Trends in number of non-executive members

4.7.6 Trend in male members in audit committees

The study intended to establish the level of gender diversity in non-commercial state corporations in Kenya. The study analysed the trends in the male members in audit committees from 2007 to 2012. The results of trend analysis revealed that the male members in audit committees in non-commercial state corporations in Kenya had been decreasing steadily from 2007 to 2012. The findings implied that male members have continued to give way for female members in audit committees in non-commercial state corporations in Kenya. Huang, Yan, Fornaro and Elshahat (2011) also conducted a study on the market reactions to audit committee director's gender with evidence from US-traded foreign firms. The study hypothesize that female members on the audit committee can strengthen corporate governance by their conservative and ethical qualities

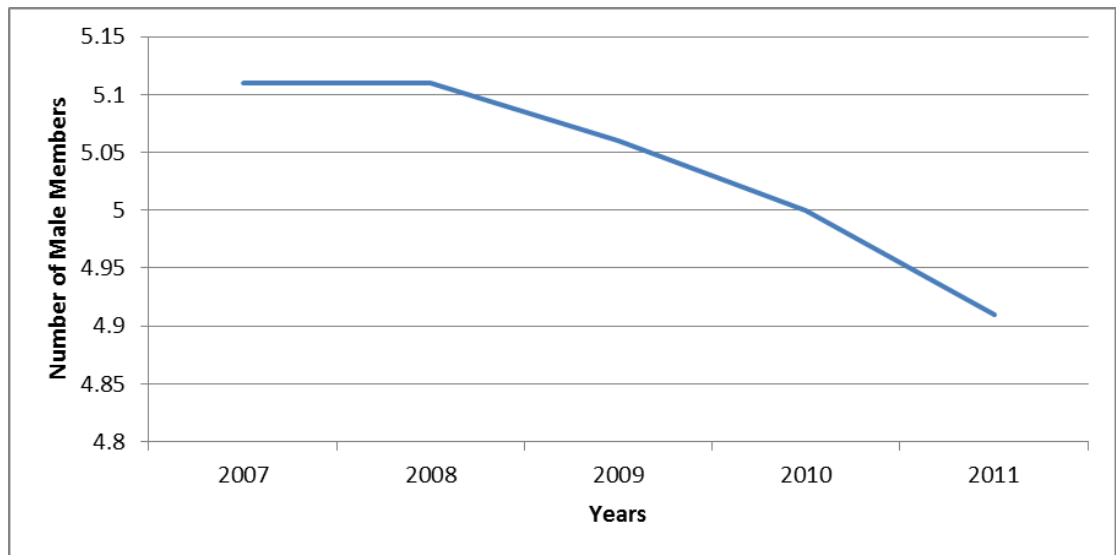


Figure 4.8 Trends in male members in audit committee

4.7.7 Trends in female members in audit committees

The study further sought to find out the trend in the female members in Audit committee in non-commercial state corporations in Kenya. The result showed that there was an increasing trend in the number of female members in audit committee in non-commercial state corporations in Kenya. The results implied that as the number of audit committee increases, the number of female members have also been increasing. Huang, Yan, Fornaro and Elshahat (2011) also conducted a study on the market reactions to audit committee director's gender with evidence from US-traded foreign firms. The study hypothesize that female members on the audit committee can strengthen corporate governance by their conservative and ethical qualities. Huse and Solberg (2006) found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership.

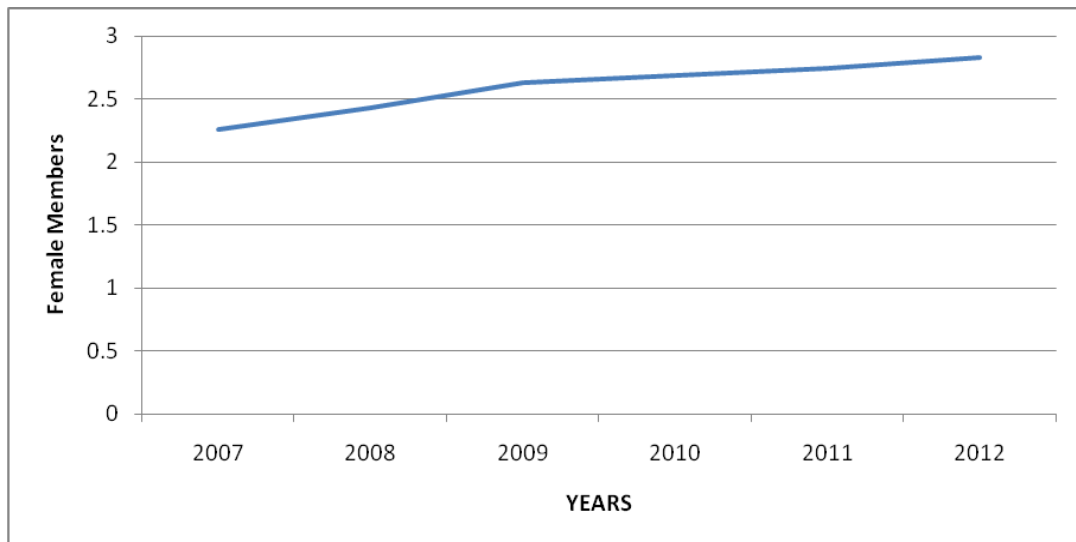


Figure 4.9 Trends in female members in audit committee

4.7.8 Trend in members with similar tenure in audit committees

To assess the level of diversity and independence, the study analysed the trend in the audit committee members with similar tenure in non-commercial state corporations in Kenya. The result showed that there was decreasing trend in the number of members with similar tenure in audit committee in non-commercial state corporations from 2007 to 2009 before increasing up to 2010. This was followed by a decrease in members with similar tenure in audit committee in state corporations from 2010 to 2012. The year 2007 had the highest number of members with similar tenure in audit committee in state corporations while 2012 had the lowest number. The study by ICPAK (2015) also established that sixty seven percent (67%) of the respondents had no succession provisions given that the tenure for all members of Boards came to an end at the same time.

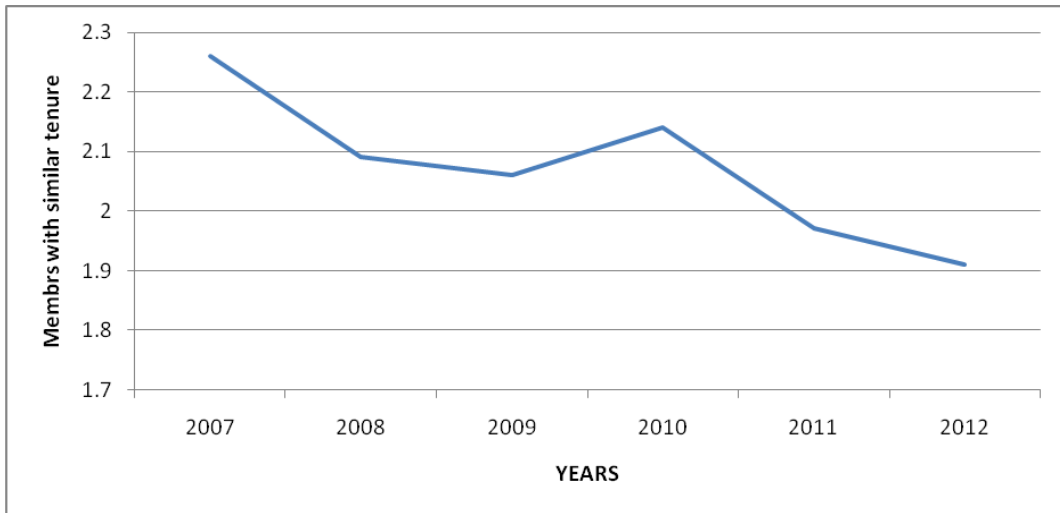


Figure 4.10 Trends in members with similar tenure in audit committee

4.7.9 Trend in age diversity of Audit committees

The study further assessed the trend in age diversity of audit committee in state corporations.

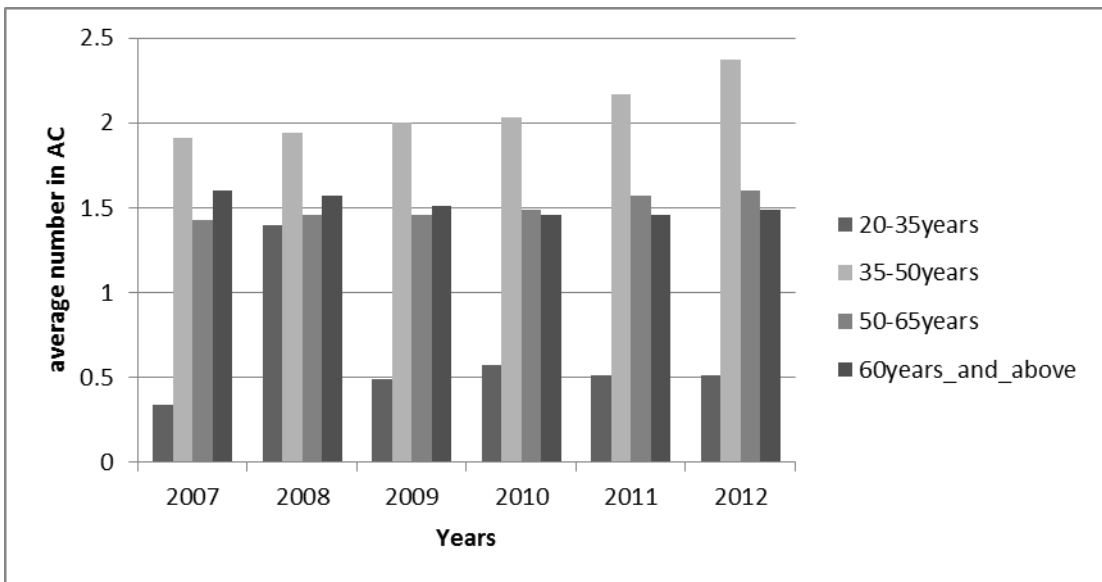


Figure 4.11: Trends in age diversity in audit committee

The trend analysis results revealed that there was an increasing trend in members between the ages of 36-50 years in audit committee in non-commercial state corporations. The year 2011 had the highest number of members between the ages of 36-50 in audit committees in state corporations with 2007 recording the lowest number. The results revealed an increase in the number of members between the ages of 51-65 years in audit committee in state corporations from the year 2009 to 2012. The year 2007 had the lowest number of members between the ages of 51-65 years in audit committee in state corporations. Trend analysis results showed that the year 2007 had the highest number of members of age 66 years and above in the audit committee in state corporations. The year 2010 and 2011 recorded the same number of members before increasing in 2012.

Miller and Del-Carmen (2009) noted that age diversity is an often overlooked element in the boardrooms. Board members tend to be older, as many boards equate age with experience. Deloitte (2014) board practices report found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The report suggested that while older directors do provide a wealth of knowledge, having younger directors introduces a fresh perspective into the boardroom which should not be underestimated.

4.7.10 Trend in number of audit committee meetings

Results showed that in the year 2007 the number of audit committee meetings in state corporations were low as compared to the year 2011 and 2012 that recorded the same number of meetings. From the year 2008 to 2011 the number of meetings of audit committee in state corporations increased. According to Stewart (2007)

increasing the frequency of committee meetings lead to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing (Lee & Mande, 2005).

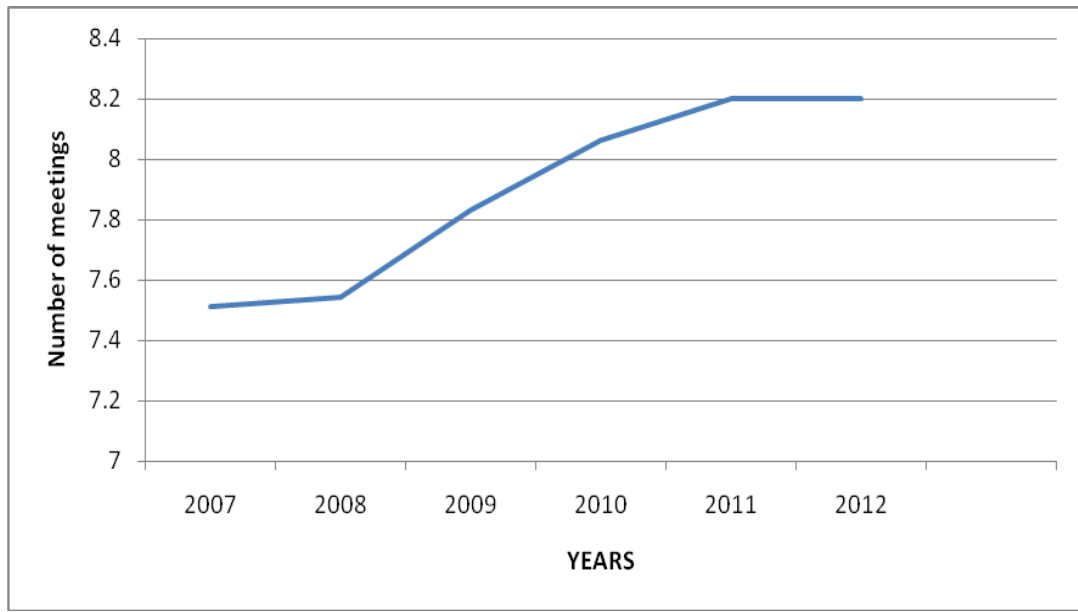


Figure 4.12: Trends in number of audit committee meetings

4.8 Descriptive Analysis Results

This section intended to establish how the respondents responded to various questions in the questionnaire. The study used percentages in the descriptive analysis.

4.8.1 Audit Committee Independence

The study sought to establish the effect of audit committee independence on quality of financial reporting in non-commercial state corporations in Kenya. The result on the statement used to measure the independence of audit committees in non-commercial state corporations is presented in Table 4.9. The findings are given on the

scale of strongly disagree (SD) to strongly agree (SA). The results for mean, standard deviation and coefficient of variation (CoV) are also presented

Table 4.9: Descriptive Results for Audit Committee Independence

	SD	D	N	Ag	SA	Me an	Std dev	CoV
Our audit committee has non-executive members	8.7%	4.3%	0.0%	34.8%	52.2%	4.2	1.22	0.29
Appointment of members in our audit committee is transparent	17.4%	10.9%	30.4%	41.3%	0.0%	3.0	1.11	0.38
Selection of chairman in our audit committee is transparent	4.3%	6.5%	17.4%	45.7%	26.1%	3.8	1.04	0.27
Audit committee members have no relationship with top management	8.7%	4.3%	21.7%	34.8%	30.4%	3.7	1.20	0.32

The study sought to establish whether audit committees in non-commercial state corporations in Kenya had non-executive members. The results showed that 52.2% and 34.8% of the respondents strongly agreed and agreed respectively. The findings further showed that 8.7% and 4.3% strongly disagreed and disagreed respectively. The statement had a mean of 4.2 which further implied that majority of the respondents agreed with the statements. The standard deviation of 1.22 and coefficient of variation of 0.29 confirmed that the response slightly varied from the mean. This finding implied that there was independence in the audit committees of non-commercial state corporations in terms of having non-executive members in the ACs. The findings of this study conform to the guidelines on audit committee in state corporations. According to ICPAK (2015) report the boards of state corporations should establish an audit committee of at least three independent and non-executive directors who should report to the board, with written terms of reference, which deal

clearly with its authority and duties. The study found that most of the boards are deemed independent and it also concurred with John and Senbet (1998) who argues that boards of directors are more independent as the proportion of outside directors increase.

The study further intended to find out whether the appointment of chairman in the audit committees in non-commercial state corporations was transparent; the results showed that the statement had a mean of 3.8 which indicated that majority of the respondents agreed. Similarly the statement had a standard deviation and coefficient of variation of 1.17 and 0.51 respectively which indicated slightly high variation of the responses from the mean an indication of varied responses on the subject. These findings implied that most of the respondents felt that the appointment of the chairman in most of the non-commercial audit committees was transparent. The finding of this study implied that the audit committee in non-commercial state corporations were independent in terms of transparency in chairman selection. According to the guideline in the ICPAK (2015) report; it states that the chairman of the audit committee should be an independent and non-executive director. Kantudu and Samaila (2015) recommended that the appointment of independent directors on the ACs should be based on the previous records of those directors in term of performance more than other factors.

The study further sought to establish whether the selection of members in the audit committee in non-commercial state corporations was transparent. The result also revealed that the statement had a mean of 3.0, standard deviation of 1.11 and coefficient of variation of 0.52 which indicate that majority of the respondents were

neutral in the response. The finding of this study implied that the audit committee in non-commercial state corporations were independent in terms of transparency in membership selection. Rezaee, Olibe and Minmier (2003) also pointed out that audit committees should comprise of members who are both independent and objective. Members should have a clear understanding of the objectives, priorities and risks of the organisation and of their roles on the committee.

The study further aimed to establish whether audit committee members have any form of relationship with top management. The statement was found to have a mean of 3.7. The results also showed that the statement had standard deviation of slightly higher than 1 and a coefficient of variation of about 0.32 which indicated that the response had a slight variation from the mean. These findings implied that the respondents agreed and strongly agreed that members of the audit committees only related professionally and had no form of relationship with management. The findings of this study support the recommendations by Kantudu and Samaila (2015) that the appointment of members of the ACs should be very independent.

The study also sought to establish the effect of audit committee diversity on quality of financial reporting in non-commercial state corporations in Kenya. The result on the statements used to measure the independence of audit committees in non-commercial state corporations is presented in Table 4.10.

Table 4.10: Descriptive Results for Audit Committee Diversity

Statements	SD	D	N	A	SA	Mean	Std dev	CoV
Age Diversity	4.3%	4.3%	4.3%	34.8%	52.2%	4.3	1.0	0.24
Regional Diversity	8.7%	2.2%	4.3%	41.3%	43.5%	4.1	1.2	0.29
Tenure Diversity	6.5%	8.7%	4.3%	39.1%	41.3%	4.0	1.2	0.30
Gender Diversity	4.3%	4.3%	4.3%	50.0%	37.0%	4.1	1.0	0.24

4.7.2.1 Age Diversity of audit committee

The study intended to find out whether audit committees in non-commercial state corporations in Kenya have members of different age groups. The results showed that 52.2% and 34.8% strongly agreed and agreed with the statement. The statement on age diversity had a mean of 4.3 which confirmed that majority of the respondents agreed that audit committees had members of different age groups. The result also revealed a standard deviation of 1.06 and coefficient of variation of 0.52 which indicated that majority of the respondents agreed and slight variation in the response. The findings however appear to contradict what other authors have reported on the issue of age group representation in the boards.

For instance, Miller and Del-Carmen (2009) noted that age diversity is an often overlooked element in the boardrooms since most board members tend to be older, as many boards equate age with experience. Deloitte (2014) report on board practices report found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The reported suggested that while older directors do provide a wealth of knowledge, having younger directors

introduces a fresh perspective into the boardroom which should not be underestimated.

4.7.2.2 Regional Diversity of audit committee

State corporations in general have the mandate to provide services to all citizens in a country therefore the aspects of regional representation in the boards and other sub committees such as audit committees is key to regional penetration. The study was interested in finding out whether the audit committees in state corporations had regional diversity. In the result presented in table 10, it indicated that the statement had a mean of 4.1, a standard deviation of 1.2 and a coefficient of variation of 0.29. These findings implied that majority of the respondents agreed that audit committees in the non-commercial state corporation had regional representation. Audit committees in most cases had membership of about 7 hence achieving regional diversity was highly likely.

4.7.2.3 Tenure Diversity of audit committee

The study further sought to find out whether audit committee members in non-commercial state corporations had different office tenure, 41.3% strongly agreed, 39.1% agreed those who disagreed were 15.2%. The findings further showed that the statement had a mean of 4.0, a standard deviation of 1.2 and a coefficient of variation of 0.30. These findings implied that majority of the respondents agreed that audit committees in the non-commercial state corporations had different office tenure. These findings however contradicted the study by ICPAK (2015) that established that sixty seven percent (67%) of all members of Boards in state corporations had tenure that would come to an end at the same time.

4.7.2.4 Gender Diversity of audit committee

Finally, the study sought to find out whether audit committees in non-commercial state corporations had both male and female members. The findings revealed that 50% of the respondents agreed, 37% strongly agreed, strongly disagree, disagree and neutral had equal proportion of 4.3% of the respondents. The findings showed that all the statement had a mean of 4.1 which implied that majority of the respondents agreed with the statements in the questionnaire. The standard deviation and coefficient of variation of the statement was 1 and 0.24 respectively implying that the responses varied slightly from the mean. The finding implied that the respondents felt that the audit committees in non-commercial state corporations were diversified in terms of gender.

Diversity in an audit committee is an important characteristic in enhancing the quality of financial reporting. For instance, different genders have different attitudes and ethical conduct in performing their duties. Bilic and Sustic (2011) found that women are more ethical in performing their duties than men. The presence of women on the board enhances the ability of the business to run healthily and a female presence is considered as a compliment to the male directors. Huang *et al.* (2011) argues that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such as manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income. Huang & Thiruvadi, (2010) found that audit committees that have at least one female director function differently than male dominated audit committees.

4.8.2 Audit Committee Members Financial Competence

The study further sought to find out the level of financial competence among the audit committee members of non-commercial state corporations. Under audit committee members' financial competence, the study aimed to establish whether audit committees in non-commercial state corporations had financial training, knowledge in financial matters, and experience in audit and risk management skills.

The results were presented in Table 4.11.

Table 4.11 Descriptive Results for Financial Competence

Statements	SD	D	N	A	SA	Me an	Std dev	CoV
Financial training of audit committee members.	8.7%	6.5%	2.2%	41.3%	41.3%	4	1.23	0.31
Knowledge in Accounting matters	6.5%	6.5%	4.3%	47.8%	34.8%	3.9	1.13	0.29
Experience in Financial reporting and audit and related fields.	2.2%	8.7%	6.5%	50.0%	32.6%	4	0.98	0.25
Knowledge in governance and risk management	6.5%	6.5%	0.0%	47.8%	39.1%	4	1.12	0.28

The study sought to know from the respondents whether the audit committee members in non-commercial state corporations in Kenya had undergone financial training. 41.3% strongly agreed, another 41.3% agreed while 8.7% and 6.5% of the respondents strongly disagreed and disagreed respectively. The findings showed that all the statements had a mean of 4.0 which implied that majority of the respondents agreed with the statements in the questionnaire. The standard deviation and coefficient of variation of the statement was 1.23 and 0.31 respectively implying that

the responses varied slightly from the mean. Matters of auditing require that audit committee members in state corporations have some knowledge on accounting and related fields hence it is necessary to have audit committee members undertake financial trainings. The findings of this study are consistent with those of Krishnan and Visvanathan (2007) who reported that financial expertise has a positive and statistically significant effect on audit committee monitoring mechanisms. Similarly, McDaniel, Martin and Maines (2002) highlighted that the level of financial knowledge and skill of audit committee members has obvious consequences in dealing with different financial issues.

The study was also interested in whether members of audit committees in non-commercial state corporations had demonstrated knowledge in financial matters, 47.8% agreed, 34.8% strongly agreed while 6.5% and 6.5% of the respondents strongly disagreed and disagreed respectively. The findings showed that all the statements had a mean of 3.9 which implied that majority of the respondents agreed with the statements in the questionnaire. The standard deviation and coefficient of variation of the statement was 1.13 and 0.29 respectively implying that the responses varied slightly from the mean. The findings of this study implied that audit committee members in non-commercial state corporations had knowledge in financial matters. The findings further implied that the audit committees in non-commercial state corporations were in a position to understand and interpret accounting language used in auditing. Agung (2015) also implied that the member background in terms of education and experience influences their focus in committee activities. The study recommended that it is wise to include members in the audit

committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas.

The study was further interested in whether, audit committee members in non-commercial state corporations had some financial reporting experience in audit and related fields. The findings revealed that 50.0% of the respondents agreed, 32.6% strongly agreed while 2.2% and 8.7% of the respondents strongly disagreed and disagreed respectively. The statement was found to have a mean of 4.0, standard deviation of 0.98 and coefficient of variation of 0.25. These findings implied that majority of the audit committee members in non-commercial state corporations had experience in financial reporting and auditing. The findings further implied that boards of non-commercial state corporations considered experience in financial reporting and auditing when selecting members of audit committees. Similarly, the findings conform to those of Agung (2015) who pointed out that a member's background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas.

Finally the study sought to establish whether the audit committee members in non-commercial state corporations had risk management skills. Risk management is important in an organisation because without it, a firm cannot possibly define its objectives for the future. If an organisation defines objectives without taking the risks into consideration, chances are that they will lose direction once any of these risks hit

home. Therefore it is prudent for audit committee members to have knowledge and skills in risk management to help avert risks.

The findings showed that 47.8% agreed, 39.1% strongly agreed while 13% of the respondents disagreed. The statement on whether audit committees of non-commercial state corporations had governance and risk management skills had a mean of 4, standard deviation of 1.12 and coefficient of variation of 0.28. These findings further confirmed that majority of the respondents agreed with the statement and further the responses varied slightly from the mean.

The findings of this study concurs with those of Bédard *et al.* (2004) who argued that, in order to fulfil their responsibilities, audit committee members should possess not only financial or accounting expertise, but also corporate governance expertise and firm-specific expertise. Similarly, DeZoort (1998) described the necessity of auditing and internal control experience for audit committee members, particularly in detecting fraudulent activities and internal control weaknesses. The audit committee members who have accounting and auditing experience can play a leading role in the committee by providing valuable views, justification, and comments, which can increase a committee's productivity.

4.8.3 Conduct of Audit Committee Meetings

The final objective this study intended to establish is the effects of audit committee meetings on quality of financial reporting in non-commercial state corporations in Kenya. Table 4.12 contains the descriptive result findings on audit committee meetings and quality of financial reporting.

Table 4.12 Descriptive Results for Audit Committee Meetings

Statements	SD	D	N	A	SA	Mean	Std Dev	CoV
Frequency of audit committee meetings.	8.7%	4.3%	8.7%	37.0%	41.3%	3.98	1.22	0.31
Adequacy of audit committee meetings.	4.3%	8.7%	4.3%	45.7%	37.0%	4.02	1.09	0.27
Relevance of agenda of audit committee meetings.	8.7%	8.7%	2.2%	26.1%	54.3%	4.09	1.31	0.32
Attendance of meetings.	6.5%	6.5%	4.3%	54.3%	28.3%	3.91	1.09	0.28

The study sought to establish whether audit committees in non-commercial state corporations hold their meetings frequently. The results indicated that 41.3% strongly agreed, 37% agreed while 8.7% strongly disagreed and 4.3% disagreed. The statement on whether audit committees of non-commercial state corporations held their meetings frequently had a mean of 3.98, standard deviation of 1.22 and coefficient of variation of 0.31. These findings further confirmed that majority of the audit committees in non-commercial state corporations held their meetings frequently. Having frequent meetings implied that audit committees in non-commercial state corporations had enough time to discuss issues conclusively. Stewart (2007) also shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote their time for the meetings.

The study further sought to establish whether audit committee in non-commercial state corporations usually have relevant agenda during their meetings. The findings revealed that the statement had a mean of 3.91, a standard deviation of 1.09 and finally a coefficient of variation of 0.28. The results of the standard deviation and coefficient of variation showed that there was slight variation in the responses while the mean indicated that majority of respondents felt that the agenda in the meetings of audit committees in state corporations were relevant. Zábajníková (2016) also acknowledged the importance of relevant and frequent meetings by audit committees. The authors argued that relevant and frequent meetings by audit committees positively enhanced quality of financial reporting.

The study also aimed to establish whether audit committee members attend meetings regularly. The results indicated that 54.3% strongly agreed while 26.1% agreed. The findings further revealed that the statement had a mean of 4.09, a standard deviation of 1.31 and finally a coefficient of variation of 0.32. The result of the standard deviation and coefficient of variation showed that there was slight variation in the responses while the mean indicated that majority of respondents felt that members of audit committees attended meetings regularly.

Finally the study sought to establish whether audit committees in non-commercial state corporations held adequate number of meetings. The findings revealed that 45.7% agreed and 37.0% strongly agreed that the meetings held by the non-commercial state corporations were adequate. The statement also had a mean of 4.02, standard deviation of 1.09 and coefficient of variation of 0.27 which further confirmed that the number of meeting held by audit committees were adequate

according to the respondents. The findings conform to ICPAK (2015) guidelines that audit committees in state corporations should meet at least once in every three months. Morrissey (2000) also suggested at least four meetings in a year for audit committees. He further claims that the best quality of financial reports can be assured, if at least four sittings are held during the year. It has also been argued by Menon and Williams (1994) that for audit committees to be effective monitors, it is not enough just to be independent and that they must be active. Being active could be measured by the number of their meetings. The number of audit committee meetings is a perceived indicator of audit committee effectiveness. Financial statement users perceive fewer meetings as an indicator of less commitment and insufficient time to oversee the financial reporting process.

4.8.4 System Automation and Staff Competence

The study sought to establish the moderating effects of system automation and staff competences of accounts staff on the relationship between audit committees and quality of financial reporting in non-commercial state corporations in Kenya. In this section the study sought to establish the level of system automation and staff competence of accounts staff in non-commercial state corporations in Kenya.

Table 4.13 Descriptive Results for System automation and staff competences of Accounts Staff

Statements	SD	D	N	A	SA	Mean	Std dev	CoV
Professional qualifications of accountants	2.2%	6.5%	2.2%	43.5%	45.7%	4.24	0.95	0.22
Continuous professional training of accountants.	8.7%	4.3%	6.5%	56.5%	23.9%	3.83	1.12	0.29
Automation level of the accounting process.	10.9%	4.3%	4.3%	45.7%	34.8%	3.89	1.25	0.32
Proper and modern book-keeping system	6.5%	6.5%	4.3%	39.1%	43.5%	4.07	1.16	0.29

On whether the state corporation has qualified accountants, 45.7% strongly agreed, 43.5% agreed while 6.5% disagreed and 2.2% strongly disagreed. The study also intended to find out whether accountants that worked in non-commercial state corporations in Kenya had full professional and continuous training. The findings indicated that 56.5% of the respondents agreed, 23.9% strongly agreed while 8.7% and 4.3% strongly disagreed and disagreed respectively. The study further sought to find out whether the accounting process in non-commercial state corporations in Kenya was fully automated. The findings indicated that 45.7% of the respondents agreed, 34.8% strongly agreed while 10.9% and 4.3% strongly disagreed and disagreed respectively. Finally the study sought to find out whether audit committees in non-commercial state corporations had proper and modern book-keeping system. The results revealed that 43.5% of the respondents strongly agreed, 39.1% agreed while equal percent of 6.5 strongly disagreed and disagreed respectively. The results

also revealed that all the statements on the automation and accounts staff qualification had a mean of above 3.8 which implied that majority of the respondents agreed and strongly agreed with the statements. The findings further showed that automation and accounts staff qualification statement had a standard deviation which was slightly higher or lower than 1 implying that the responses varied slightly from the mean.

The findings in this section showed that non-commercial state corporations had automated their systems and had qualified accounts staff. Abdallah (2013) also assessed the impact of using accounting information systems on the quality of financial statements submitted to the Income and sales tax Department in Jordan. The study recommended focusing on the development of the devices used in the department, training and development of staff to enable them continue to perform their jobs and improve the quality of financial statements in the department.

Ismail and King (2007) also found out that the information systems of accounting work smoothly as they connect information from the top and bottom to help workers in companies achieve their goals. In addition, using these systems will enable companies to give accurate information to the relevant government agencies. Computerized accounting systems automate the accounting process thus improving efficiency and cutting down costs and it tends to be more accurate, faster to use, and less subject to error than its manual counterpart.

Indira (2008) further pronounced the improvement in business performance as a result of computerization of the accounting systems as it is a highly integrated application that transforms the business processes with the performance enhancing features which encompass accounting, inventory control, reporting and statutory processes. He added that, this may help the company access information faster and takes quicker decisions as it also enhances communication.

4.9 Correlation Tests Results

The study also employed correlation analysis to further ascertain the association between independent and dependent variables. This section contains results of correlation tests conducted to test the association between independent and dependent variables. Kothari (2014) further stated that the importance of correlation is to determine the extent to which changes in the value of an attribute is associated with changes in another attribute.

4.9.1 Audit Committee Independence and Ratio of Queried Transactions to Annual Budget

The study intended to establish the relationship between audit committee independence and ratio of queried transactions to annual budget which was adopted as measure of quality of financial reporting in non-commercial state corporations in Kenya. The results are presented in Table 4.14.

Table 4.14: Correlation Results for Audit Committee Independence and Ratio of Queried Transactions to Annual Budget

		Ratio of Queried Transactions to Annual Budget	Audit committee Independence
Ratio of Queried Transactions to Annual Budget	Pearson Correlation	1	-0.352*
	Sig. (2-tailed)		.016
	N	46	46
Audit committee Independence	Pearson Correlation	-0.352*	1
	Sig. (2-tailed)	.016	
	N	46	46

*, Correlation is significant at the 0.05 level (2-tailed).

The correlation test results revealed a negative and significant association ($r=-0.352$, $p=0.016$) between audit committee independence and quality of financial reporting as measured by the ratio of queried transactions to annual budget in non-commercial state corporations in Kenya. The findings implied that increase in the audit committee independence reduces the ratio of queried transactions which further imply increase in the quality of financial reporting. Increasing audit committee independence entails including non-executive directors, having transparency in selecting the committee members and their chairman and ensuring there is professional relationship between management and audit committee members.

Similarly, Ghafran (2013) conducted a study on audit committees and financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The author found that independent audit committees exert a significant positive impact on the quality of reported earnings. Studies done in Nigeria by

Madakawi (2012) and Madawaki and Amran (2013) on the audit committee characteristics and financial reporting quality in Nigerian listed companies reported that audit committees having an independent chair and audit committee expertise were positively associated with financial reporting quality. Madakawi (2012) recommended that regulatory bodies in Nigeria should mandate all the three board representatives on audit committee to be non-executive directors, while making a combination of financial and industrial expertise replace financial literacy to further improve quality of financial reporting.

A study by Beasley, Carcello, Hermanson and Neal (2000) found companies that committed fraud had less independent audit committees compared to their counterparts that did not commit fraud. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals. Bedard *et al.* (2004) investigated the association between different audit committee characteristics and earnings management. They found that aggressive earnings management is negatively associated with the presence of an independent audit committee.

4.9.2 Audit Committee Diversity and Ratio of Queried Transactions to Annual Budget.

The second objective of this study was aimed at establishing the effects of audit committee's diversity on the quality of financial reporting in non-commercial state corporations in Kenya.

Table 4.15: Correlation Results for Audit Committee Diversity and Ratio of Queried Transactions

		Ratio of Queried Transactions to Annual Budget	Audit committee Diversity
Ratio of Queried Transactions to Annual Budget	Pearson Correlation	1	-0.392**
	Sig. (2-tailed)		.004
	N	46	46
Audit committee Diversity	Pearson Correlation	-0.392**	1
	Sig. (1-tailed)	.004	
	N	46	46

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

The findings showed that audit committee diversity had a negative and significant ($r=-0.392$, $p=0.004$) association with quality of financial reporting measured by the ratio of queried transactions to annual budget. Increasing diversity was found to have positive effects with quality of financial reporting since it reduced the ratio of queried transactions to annual budget. The findings of this study therefore implied that having audit committee with generational diversity, regional diversity, tenure diversity and gender diversity would assist in improving the quality of financial reporting by non-commercial state corporations.

Huse and Solberg (2006) also found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership. Deloitte (2014) report on board practices found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The report suggested that while older directors do provide a

wealth of knowledge, having younger directors introduces a fresh perspective into the boardroom which should not be underestimated. Huang and Thiruvadi, (2010) found that audit committees that have at least one female director function differently than all male audit committees.

The findings of this study further concur with Bilic and Sustic (2011) who also found that women are more ethical in performing their duties than men. The presence of women on the board enhances the ability of the business to run healthily and a female presence is considered as a complement to the male directors. Similarly, Huang *et al.* (2011) argued that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income.

Davidson, Xie and Ning (2007) also noted that younger managers are likely to engage in earnings management, while older managers mostly concentrate on future security, hence, have less ability to generate new ideas and more concerned about future security. This argument is interpreted to mean that quality of financial information is a function of top management team's (TMT) age. Finally, Sundaram and Yermack (2007) found a positive relationship between age and ethical behaviour on financial reporting quality.

4.9.3 Audit Committee Financial Competence and Ratio of Queried Transactions to Annual Budget

This study further aimed at establishing the effects of financial competence of audit committee members on the quality of financial reporting in non-commercial state corporations in Kenya.

Table 4.16: Correlation Results for Financial Competence and Ratio of Queried Transactions to Annual Budget

		Ratio of queried Transactions to Annual Budget	Audit committee Finance Competence
Ratio of queried Transactions to Annual Budget	Pearson Correlation	1	-0.425**
	Sig. (2-tailed)		.002
	N	46	46
Audit committee Finance Competence	Pearson Correlation	-0.425**	1
	Sig. (2-tailed)	.002	
	N	46	46

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

The findings showed that audit committee financial competence had a negative and significant ($r=-0.425$, $p=0.002$) association on ratio of queried transactions to annual budget. The results implied that increasing financial competence was found to have positive effects with quality of financial reporting since it reduced the ratio of queried transactions to annual budget. The findings further implied that audit committees with financial training, knowledge in financial matters, and experience in audit and risk management skills have significant input in enhancing the quality of financial reporting.

McDaniel, Martin and Maines (2002) highlighted that the level of financial knowledge and skill of audit committee members has obvious consequences in dealing with different financial issues. Agung (2015) study implied that the member's background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas. Similarly, DeZoort (1998) described the necessity of auditing and internal control experience for audit committee members, particularly in detecting fraudulent activities and internal control weaknesses

4.9.4 Conduct of Audit Committee Meetings and Ratio of Queried Transactions to Annual Budget

Audit committee meetings play an important role in overseeing the firms' financial reports, internal accounting control, the audit process and more recently, its risk management practices. This study aimed at establishing the effects of audit committee meetings on the quality of financial reporting in non-commercial state corporations in Kenya. The findings are presented in Table 4.17.

Table 4.17: Correlation Results for Conduct of Audit Committee Meetings and Ration of Queried Transaction

		Ratio of queried Transactions to Annual Budget	Audit committee Meetings
Ratio of queried Transactions to Annual Budget	Pearson Correlation Sig. (2-tailed) N	1 46	-0.451** .001 46
Audit committee Meetings	Pearson Correlation Sig. (1-tailed) N	-0.451** .001 46	1 46

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

The correlation results showed that audit committee meetings had a negative and significant ($r = -0.451$, $p = 0.001$) association with ratio of queried transaction to annual budget. The results implied that increasing audit committee meetings was found to have positive effects on quality of financial reporting since it reduced the ratio of queried transactions to annual budget.

Having frequent meetings implied that audit committees in non-commercial state corporations have enough time to iron out issues. ICPAK (2015) report noted that members of the audit committee should be paid an allowance on account of attendance of audit committee meetings as determined by National Treasury in consultation with other relevant entities. Stewart (2007) also shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing. Morrissey (2000) also suggested at least four meetings in a year for audit committees. He further claims that the best quality of financial reports

can be assured, if at least four sittings are held during the year. It has also been argued by Menon and Williams (1994) that for audit committees to be effective monitors, it is not enough just to be independent but they must be active as well. Being active could be measured by the frequency of their meetings. The number of audit committee meetings is a perceived indicator of audit committee effectiveness. Financial statement users perceive fewer meetings as an indicator of less commitment and insufficient time to oversee the financial reporting process.

Bryan, Liv and Tiras (2004) on the other hand posited that audit committees that meet regularly improve the transparency and openness of reported earnings and therefore improve earnings quality. Similar views were held by Zhang, Zhou and Zhou (2007) who used the number of meetings to measure whether frequency of meetings influence financial reporting quality and found a positive correlation. However, the findings disagreed with Vafes (2005) who found a negative relationship between the number of meetings and earnings management.

4.10 Regression Analysis Results

To investigate the nature and strength of the relationship between audit committees of non-commercial state corporations and quality of financial reporting, the study adopted the use of ordinary least squares regression analysis. Kothari (2014) defines regression as the determination of a statistical relationship between two or more variables. In simple regression, there are two variables, one variable (defined as independent) is the cause of the behaviour of another one (defined as dependent variable). When there are two or more than two independent variables, the analysis concerning relationship is known as multivariate regression and the equation

describing such relationship is known as the multiple regression equation. Kothari (2014) described Analysis of Variance (ANOVA) as a procedure for testing the difference among different groups of data for homogeneity. The essence of ANOVA is that the total amount of variation in a set of data is broken down into two types, that amount which can be attributed to chance and that amount which can be attributed to specified causes. F-test was also used in the context of ANOVA for judging the significance of multiple correlation coefficients.

4.10.1 Effect of Audit Committee Independence on Quality of Financial Reporting

4.10.1.1 Univariate Regression Results for Audit Committee Independence Quality of Financial Reporting

The study sought to determine the relationship between audit committee independence and quality of financial reporting which was measured by the ratio of queried transactions to annual budget. The study used regression to test the relationship between audit independence sub constructs and quality of financial reporting.

Table 4.18: Model Summary for Audit Committee Independence Sub constructs

Model	1
R	.526
R Square	0.277
Adjusted R Square	0.186
Std. Error of the Estimate	2.908889
F-statistics	13.063 (0.020)

The findings showed that presence of non-executive members, transparency in appointment of members, transparency in selection of chairman and audit committee members non-relationship with top management accounted for 27.7% of the variation in queried transactions to annual budget. The model used was also statistically significant as shown by F-statistic =13.063 (p=0.020).

Table 4.19: Coefficients for Audit Committee Independence Sub constructs

	B	Std. Error	T	Sig.
(Constant)	8.609	2.648	3.251	0.002
Presence of non-executive members	-7.876	2.702	-2.914	0.006
Transparency in selection of chairman	-7.748	2.135	-3.63	0.001
Transparency in appointment of members	-0.201	0.389	-0.517	0.608
Audit committee members relationship With top management	-1.236	0.385	-3.207	0.003

The findings revealed that numbers of non-executive members had a coefficient of -7.876 and significance value of 0.006 meaning presence of non-executive members in audit committees of non-commercial state corporations in Kenya had negative relationship with the ratio of queried transactions to annual budget. These findings implied that increasing the number of non-executive members in audit committees enhanced quality of financial reporting.

The results also revealed that transparency in selection of chairman was found to have negative and significant relationship with ratio of queried transactions to annual budget ($\beta=-7.748$, $p=0.001$). Transparency in appointment of members had a negative relationship with the ratio of queried transactions to annual budget. However the relationship was statistically insignificant. Audit committee members

relationship with top management was also found to have a negative and significant relationship with ratio of queried transactions to annual budget ($\beta=-1.236$, $p=0.003$).

Madakawi (2012) recommended that regulatory bodies in Nigeria should mandate all the three board representatives on audit committee to be non-executive directors, while making a combination of financial and industrial expertise replace financial literacy to further improve the quality of financial reporting. A study by Beasley, Carcello, Hermanson and Neal (2000) found companies that committed fraud had less independent audit committees compared to their counterparts that did not commit fraud. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals.

4.10.1.2 Overall Regression Results for Audit Committee Independence and Quality of Financial Reporting

The regression analysis for audit committee independence and ratio of queried transactions to annual budget revealed that audit committee independence explained 12.4% of the variation in the ratio of queried transactions to annual budget ($R^2=0.124$) while the remaining percentage of 87.6% was explained by other variables not in this model.

Table 4.20: Model Summary for Audit Committee Independence

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.352 ^a	.124	.104	3.0529583647

a. Predictors: (Constant), Audit committee Independence

F-test was carried out to test the null hypothesis that there is no significant impact of audit committee independence on quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The results of ANOVA test show that the F value is 6.217 with a significance of p value = 0.016 which is less than 0.05, meaning that null hypothesis was rejected and concluded that there is a relationship between audit committee independence and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya.

Table 4.21: ANOVA for Audit Committee Independence

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	57.944	1	57.944	6.217	.016 ^b
	Residual	410.104	44	9.321		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Independence

To further test the significance of regression relationship between audit committee independence and quality of financial reporting (ratio of queried transactions to annual budget), the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to t-test to test the null hypothesis that the coefficients are zero. The null hypothesis states that, β (beta) = 0, meaning there is no significant relationship between audit committee independence and quality of financial reporting as the slope β (beta) = 0 (no relationship between the two variables).

Table 4.22: Regression Coefficients for Audit Committee Independence and Quality of Financial Reporting

	B	Std. Error	Beta	t	Sig.
(Constant)	7.876	2.702		2.914	0.006
Audit committee Independence	-2.073	0.832	-0.352	-2.493	0.016

a Dependent Variable: Ratio of queried Transactions to Annual Budget

The results on the beta coefficient of the resulting model showed that the constant $\alpha = 7.876$ was significantly different from 0, since the p- value = 0.006 was less than 0.05. The coefficient $\beta = -2.073$ was also significantly different from 0 with a p-value=0.016 which was less than 0.05. The results imply that a unit change in audit committee independence will result in -2.073 units change in ratio of queried transactions to annual budget. This confirms that there is a significant negative linear relationship between audit committee independence and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implies improved quality of financial reporting therefore these findings further implied that increase in audit committee independence was found to result to increase in quality of financial reporting.

Similarly, Ghafran (2013) conducted a study on audit committees and financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The author found that independent audit committees exert a significant positive impact on the quality of reported earnings. Studies done in Nigeria by

Madakawi (2012) and Madawaki and Amran (2013) on the audit committee characteristics and financial reporting quality in Nigerian listed companies reported that audit committees having an independent chair and audit committee expertise were positively associated with financial reporting quality. Madakawi (2012) recommended that regulatory bodies in Nigeria should mandate all the three board representatives on audit committee to be non-executive directors, while making a combination of financial and industrial expertise replace financial literacy to further improve the quality of the financial reporting.

A study by Beasley, Carcello, Hermanson and Neal (2000) found companies that committed fraud had less independent audit committees compared to their counterparts that did not commit fraud. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals. Bedard *et al.* (2004) investigated the association between different audit committee characteristics and earnings management. They found that aggressive earnings management is negatively associated with the presence of an independent audit committee.

4.10.2 Effect of Audit Committee Diversity on Quality of Financial Reporting

4.10.2.1 Univariate Regression Results for Audit Committee Diversity Quality of Financial Reporting

The second objective of this study was to determine the relationship between audit committee diversity and quality of financial reporting. Diversity was measured by

while quality of financial reporting was measured by ratio of queried transactions to annual budget of the non-commercial state corporations.

Table 4.23: Model Summary for Audit Committee Diversity Sub constructs

Model	1
R	0.486
R Square	0.237
Adjusted R Square	0.162
Std. Error of the Estimate	2.952199
F-statistics	23.176 (0.023)

The findings revealed that age diversity, regional diversity, tenure diversity and gender diversity explained 23.7% of the variation in ratio of queried transactions to annual budget. The F-statistics = 23.176 (p=0.023) further showed that age diversity, regional diversity, tenure diversity and gender diversity were significant predictors of quality of financial reporting.

Table 4.24: Coefficients of Audit Committee Diversity Sub constructs

	B	Std. Error	t	Sig.
(Constant)	6.848	2.5	2.74	0.009
Age Diversity	-7.908	2.035	-3.886	0
Regional Diversity	-0.877	0.408	-2.151	0.037
Tenure Diversity	0.309	0.387	0.798	0.429
Gender Diversity	-0.539	0.197	-2.74	0.009

The findings revealed that age and had a negative and significant relationship with ratio of queried transactions to annual budget. The findings implied that an increase in age diversity and regional diversity would reduce the ratio of queried transaction to annual budgets. The finding further established that tenure diversity had positive and insignificant relationship with the ratio of queried transactions to annual budget.

The results finally showed that gender diversity had a negative and significant relationship with ratio of queried transactions to annual budget. Increasing the gender diversity would reduce the ratio of queried transactions hence increase the quality of financial reporting.

The findings of this study concur with Bilic and Sustic (2011) who also found that women are more ethical in performing their duties than men. The presence of women on the board enhances the ability of the business to run healthily and a female presence is considered as a complement to the male directors. Deloitte (2014) report on board practices found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The report suggested that while older directors do provide a wealth of knowledge, having younger directors introduce a fresh perspective into the boardroom which should not be underestimated.

4.10.1.2 Overall Regression Results for Audit Committee Diversity and Quality of Financial Reporting

A regression model was fitted with audit committee diversity as the independent variable while ratio of queried transactions to annual budget as the dependent variable. The model summary result indicated that audit committee diversity explained 15.3% of the variation in the ratio of queried transactions to annual budget ($R^2=0.153$) while the remaining percentage of 84.7% was explained by other variables not in this model.

Table 4.25: Model Summary for Audit Committee Diversity

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.392 ^a	.153	.134	3.0010855170

a. Predictors: (Constant), Audit committee Diversity

F-test was further carried out to test the null hypothesis that there is no significant impact of audit committee diversity and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The results of ANOVA test show that the F value was 7.968 with a significance of p value = 0.007 which was less than 0.05, meaning that null hypothesis was rejected and concluded that there is a relationship between audit committee diversity and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya.

Table 4.26: ANOVA for Audit Committee Diversity

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	71.762	1	71.762	7.968	.007 ^b
1	Residual	396.287	44	9.007		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Diversity

To further test the significance of regression relationship between audit committee diversity and quality of financial reporting (ratio of queried transactions to annual budget), the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficients are zero.

Table 4.26: Regression Coefficients for Audit Committee Diversity

	B	Std. Error	Beta	T	Sig.
(Constant)	2.46	1.381		1.781	0.082
Audit committee Diversity	-1.117	0.396	-0.392	-2.823	0.007

a Dependent Variable: Ratio of queried Transactions to Annual Budget

The results on the beta coefficient of the resulting model showed that the constant $\alpha = 2.46$ was significantly different from 0, but statistically insignificant since the p-value = 0.082 was greater than 0.05. The coefficient $\beta = -1.117$ was significantly different from 0 with a p-value=0.007 which was less than 0.05. The results imply that a unit change in audit committee diversity will result in -1.117 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee diversity and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya.

The reduction in the ratio of queried transactions to annual budget implies improved quality of financial reporting therefore these findings further implied that increase in audit committee diversity was found to result to increase in quality of financial reporting. Huse and Solberg (2006) also found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership.

Deloitte (2014) report on board practices found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The report suggested that while older directors do provide a wealth of knowledge, having younger directors introduce a fresh perspective into the boardroom which should not be underestimated.

The findings of this study concur with Bilic and Sustic (2011) who also found that women are more ethical in performing their duties than men. The presence of women on the board enhances the ability of the business to run healthily and a female presence is considered as a complement to the male directors. Similarly, Huang *et al.* (2011) argued that women are more sensitive to establishing communications and helping others, hence, are less likely to do unethical actions such manipulation of earnings, timeliness lag in reporting financial information, withholding vital information and reporting over ambitious income. Huang and Thiruvadi, (2010) found that Audit committees that have gender diversity function differently than all male audit committees.

4.10.3 Effect of Audit Committee Financial Competence on Quality of Financial Reporting

4.10.3.1 Univariate Regression Results for Audit Committee Financial Competence and Quality of Financial Reporting

The study further sought to determine the relationship between financial competencies of audit committee members and quality of financial reporting. Financial competence was measured using financial training, knowledge in financial matters, financial reporting experience and knowledge of governance and risk management whereas the study measured the quality of financial reporting using the ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. Besides using correlation and descriptive tests to ascertain this relationship between financial competence and quality of financial reporting the study employed linear regression analysis.

Table 4.27: Model Summary for Audit Committee Competence Sub Constructs

Model	1
R	0.59
R Square	0.348
Adjusted R Square	0.247
Std. Error of the Estimate	2.797742
F-statistics	33.466(0.000)

The results showed that financial training, knowledge in financial matters, financial reporting experience and knowledge of governance and risk management accounted for 34.8% of the variation in ratio of queried transaction to annual budget. The finding also revealed f-statistics of 33.466 and a significance value of 0.000 which

was less than 0.05 meaning the independent variables were significant predictors of quality of financial reporting.

Table 4.28: Coefficients of Audit Committee Competence Sub constructs

	B	Std. Error	T	Sig.
(Constant)	8.833	2.133	4.141	0.000
Financial training of audit committee members	-0.238	0.08	-2.968	0.004
Knowledge in Accounting matters	-0.459	0.093	-4.949	0.000
Experience in financial reporting and audit and related fields	-0.427	0.609	-0.702	0.487
Knowledge of governance and risk management	-1.36	0.417	-3.262	0.002

The finding revealed that audit committee members' financial training ($\beta=-0.238$, $p=0.004$), audit committee members knowledge in accounting matters ($\beta=-0.459$, $p=0.000$), and audit committee knowledge of governance and risk management ($\beta=-1.36$, $p=0.002$), had a negative and significant relationship with the ratio of queried transactions. The finding implied that audit committee members' financial training, audit committee members knowledge in accounting matters and audit committee knowledge of governance and risk management increased the quality of financial reporting. On the other hand financial reporting experience was found to have negative but insignificant relationship with ratio of queried transactions.

The finding concurs with Agung (2015) who implied that the member background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas. Similarly,

DeZoort (1998) described the necessity of auditing and internal control experience for audit committee members, particularly in detecting fraudulent activities and internal control weaknesses.

4.10.3.2 Overall Regression Results for Audit Committee Financial Competence and Quality of Financial Reporting

The model summary result of the regression analysis indicated that audit committee financial competence explained 18.1% of the variation in the ratio of queried transactions to annual budget ($R^2=0.181$) while the remaining percentage of 81.9% was explained by other variables not in this model. The results revealed that the variation in dependent variable explained by audit committee financial competence was higher than that explained by audit committee independence and diversity respectively.

Table 4.29: Model Summary for Audit Committee Financial Competence

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.425 ^a	.181	.162	2.9517008815

a. Predictors: (Constant), Audit committee Finance Competence

The results of ANOVA test show that the F value was 9.721 with a significance of p value = 0.003 which was less than 0.05, meaning that null hypothesis was rejected and concluded that there is a relationship between audit committee financial competence and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya.

Table 4.30: ANOVA for Audit Committee Financial Competence

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	84.697	1	84.697	9.721	.003 ^b
	Residual	383.352	44	8.713		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Finance Competence

To further test the significance of regression relationship between audit committee financial competence and quality of financial reporting (ratio of queried transactions to annual budget), the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficients are zero.

Table 4.31: Regression Coefficients for Audit Committee Financial Competence

	B	Std. Error	Beta	t	Sig.
(Constant)	7.748	2.135		3.63	0.001
Audit committee Financial Competence	-1.622	0.52	-0.425	-3.118	0.003

a Dependent Variable: Ratio of queried Transactions to Annual Budget

The coefficient $\beta = -1.622$ was significantly different from 0 with a p-value=0.003 which was less than 0.05. The results imply that a unit change in audit committee financial competence will result in -1.622 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee financial competence and ratio of

queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these findings further implied that increase in audit committee financial competence was found to result to increase in quality of financial reporting.

McDaniel, Martin and Maines (2002) also highlighted that the level of financial knowledge and skill of audit committee members has obvious consequences in dealing with different financial issues. Agung (2015) study implied that the member background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas. Similarly, DeZoort (1998) described the necessity of auditing and internal control experience for audit committee members, particularly in detecting fraudulent activities and internal control weaknesses.

4.10.4 Effect of Conduct of Audit Committee Meetings on Quality of Financial Reporting

4.10.4.1 Univariate Regression Results for Audit Committee Meetings and Quality of Financial Reporting

The study was interested in establishing the relationship between audit committee meetings and quality of financial reporting in non-commercial state corporations. The study assessed the frequency, adequacy, agenda, and attendance of meetings by

the audit committees of non-commercial state corporations and how they affect the quality of financial reporting.

Table 4.32: Model Summary for Audit Committee Meetings Sub Constructs

Model	1
R	0.56
R Square	0.314
Adjusted R Square	0.247
Std. Error of the Estimate	2.79925
F-statistics	41.683 (0.000)

The findings revealed that meetings frequency, adequacy of meeting held by the audit committee, relevance of agenda and attendance of meetings explained 31.4% of the variation in ratio of queried transactions to annual budget. The finding also revealed f-statistics of 41.680 and a significance value of 0.000 which was less than 0.05 meaning meetings frequency, adequacy of meeting held by the audit committee, relevance of agenda and attendance of meetings were significant predictors of quality of financial reporting.

Table 4.33: Coefficients of Audit Committee Meetings Sub constructs

	B	Std. Error	t	Sig.
(Constant)	8.046	2.023	3.977	0.000
Frequency of meetings	-1.019	0.448	-2.273	0.028
Adequacy of meetings	0.499	0.47	1.062	0.295
Relevance of agenda	-0.02	0.393	-0.051	0.959
Attendance of meetings	-1.197	0.428	-2.798	0.008

The findings revealed meeting frequency and attendance of meetings had a significant relationship with queried transactions to annual budget. This finding implied that meeting frequency and attendance of meetings increased quality of financial reporting. The findings revealed that adequacy of meetings held by the audit committee had a positive but insignificant relationship with queried transactions to annual budget. The results further revealed that relevance of agenda of audit committee meetings had a negative and insignificant relationship with queried transactions to annual reports. The findings implied increasing relevance of agenda would enhance the quality of financial reporting.

Stewart (2007) also shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing. Morrissey (2000) suggested at least four meetings in a year for audit committees. He further claims that the best quality of financial reports can be assured, if at least four sittings are held during the year.

4.10.4.2 Overall Regression Results for Conduct of Audit Committee Meetings and Quality of Financial Reporting

The model summary result of the regression analysis indicated that audit committee meetings explained 20.4% of the variation in the ratio of queried transactions to annual budget ($R^2=0.204$) while the remaining percentage of 79.6% was explained by other variables not in this model. This was higher than all the other independent variables namely independence, diversity and financial competence.

Table 4.35: Model Summary for Conduct of Audit Committee Meetings

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.451 ^a	.204	.186	2.9102117351

a. Predictors: (Constant), Audit committee Meetings

The results of ANOVA test show that the F value was 11.264 with a significance of p value = 0.002 which was less than 0.05, meaning that null hypothesis was rejected and concluded that there is a relationship between audit committee meetings and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya.

Table 4.36: ANOVA for Conduct of Audit Committee Meetings

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	95.398	1	95.398	11.264	.002 ^b
	Residual	372.651	44	8.469		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Meetings

To further test the significance of regression relationship between audit committee meetings and quality of financial reporting (ratio of queried transactions to annual budget), the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficients are zero.

Table 4.37: Regression Coefficients for Conduct of Audit Committee Meetings

	B	Std. Error	Beta	t	Sig.
(Constant)	7.908	2.035		3.886	0
Audit committee Meetings	-1.669	0.497	-0.451	-3.356	0.002

a Dependent Variable: Ratio of queried Transactions to Annual Budget

The coefficient $\beta = -1.669$ was significantly different from 0 with a p-value=0.002 which was less than 0.05. The results imply that a unit change in audit committee meetings will result in -1.669 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee meetings and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these findings further implied that increase in audit committee meetings was found to result to increase in quality of financial reporting.

Stewart (2007) shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing. Morrissey (2000) suggested at least four meetings in a year for audit committees. He further claims that the best quality of financial reports can be assured, if at least four sittings are held during the year. It has also been argued by Menon and Williams (1994) that for audit committees to be effective monitors, it is not enough just to be independent but they must be active too. Being active could be measured by the frequency of their meetings. The number of audit committee meetings is a perceived indicator of audit

committee effectiveness. Financial statement users perceive fewer meetings as an indicator of less commitment and insufficient time to oversee the financial reporting process. Xie *et al.* (2003) found that increased audit committee activity (the number of committee meetings) is associated with reduced levels of earnings management. Bryan, Liv and Tiras (2004) on the other hand posited that audit committees that meet regularly improve the transparency and openness of reported earnings and therefore improve earnings quality. Similar views were held by Zhang, Zhou and Zhou (2007) who used the number of meetings to measure whether frequency of meetings influences financial reporting quality and found a positive correlation. However, the finding disagreed with Vafes (2005) who found a negative relationship between the number of meetings and earnings management.

4.10.5 Multivariate Regression Analysis

A multivariate regression model was conducted to test the joint relationship of all the independent variables and the dependent variable. The results showed that audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings had a significant association with ratio of queried transactions to annual budget ($R=0.703$). The results further revealed that audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings jointly accounted for 49.4% of the variation in quality of financial reporting measured by ratio of queried transactions to annual budget in non-commercial state corporations.

Table 4.38: Overall Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.703 ^a	.494	.458	2.3753113129

a. Predictors: (Constant), Audit committee Independence, Audit committee Diversity, Audit committee Financial Competence, Audit committee Meetings

The results of ANOVA indicate that audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings were significant predictor variables of quality of financial reporting measured by ratio of queried transactions to annual budget in non-commercial state corporations. This is indicated by the F-statistics results (F=13.652, p=0.000) indicating that the model used to link the independent variables and dependent variable was statistically significant.

Table 4.39: Overall ANOVA Results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	231.080	3	77.027	13.652	.000 ^b
	Residual	236.968	42	5.642		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Independence, Audit committee Diversity, Audit committee Financial Competence, Conduct of Audit committee Meetings

In the multivariate regression model, audit committee independence, audit committee diversity, audit committee financial competence, and audit committee meetings were found to have a negative and significant relationship with quality of financial

reporting measured by ratio of queried transactions to annual budget in non-commercial state corporations because the p-value was less than 0.05 which was the level of significance adopted in this study. Audit committee financial competence in the multivariate regression was found to have a negative but insignificant relationship with quality of financial reporting measured by ratio of queried transactions to annual budget in non-commercial state corporations.

Table 4.40: Multivariate Regression Coefficient Results

	B	Std. Error	Beta	T	Sig.
(Constant)	7.089	2.724		2.602	0.013
Audit committee Independence	-2.205	0.741	-0.53	-2.977	0.005
Audit committee Diversity	-1.244	0.352	-0.436	-3.538	0.001
Audit committee Finance Competence	-1.252	0.659	-0.328	-1.90	0.064
Conduct of Audit committee Meetings	-1.311	0.446	-0.355	-2.941	0.005

Optimal Model

The multivariate equation $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$ hence became *Ratio of queried Transactions to Annual Budget* = 7.089 + -2.205 (*Audit committee Independence*) + -1.244 (*Audit committee Diversity*) + -1.252 (*Audit committee Financial Competence*) + -1.311 (*Conduct of Audit committee Meetings*) + ϵ

The equation above implies that a unit increase in Audit committee Independence will result to -2.205 units change in Ratio of queried Transactions to Annual Budget.

The equation further showed that a unit increase in Audit committee Diversity will cause a change of -1.244 units in Ratio of queried Transactions to Annual Budget.

The result also implied that a unit change in Audit committee Financial Competence will cause a change of -1.252 units in Ratio of queried Transactions to Annual

Budget. Finally, a unit change in Audit committee Meetings will result in the change of -1.311 units in the Ratio of queried Transactions to Annual Budget. A reduction in the Ratio of queried Transactions to Annual Budget implies that there will be a reduction in the value of queried transactions which will result in improved quality of financial reporting in non- commercial state corporations.

Similarly, Ghafran (2013) conducted a study on audit committees and financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The author found that independent audit committees exert a significant positive impact on the quality of reported earnings. Huse and Solberg (2006) found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership. Agung (2015) study implied that the member background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas. Stewart (2007) shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing

4.11 Test for Moderation Effects of System Automation and Staff Competence

The final objective of this study was to investigate the moderating effect of system automation and staff competence on the relationship between audit committees and

quality of financial reporting in non-commercial state corporations in Kenya. The regression analysis was performed for each independent variable and the dependent variable to establish the individual moderating influence of system automation and staff competences on relationship between each audit committee variable and quality of financial reporting in non-commercial State Corporations. Aldwin (1994), Holmbeck (1997) and Kim *et al.* (2001) posited that if the change in the coefficient of determination (R^2) for the interaction variable is positive and significant, then it is said to have a moderating effect, and thus, the moderation hypothesis is supported. The null hypothesis of no moderation was tested by regressing each interaction variable with the independent variables.

4.11.1 Moderating effect of system automation and staff competence on relationship between audit committee independence and quality of financial reporting

Regression analysis was performed to determine the moderating effect of system automation and staff competence on relationship between audit committee independence and quality of financial reporting. The interaction between audit committee independence and system automation and staff competence (Audit committee Independence* system automation and staff competence) was calculated and used in the regression model $Y = \beta_0 + \beta_1$ (Audit committee Independence* system automation and staff competence) + β_2 Audit committee Independence + e. According to the results, the value of R square without consideration of the system automation and staff competence was 12.4%. The R square improved to 58.4% when the system automation and staff competence was considered. This implied that system

automation and staff competence positively enhanced the relationship between audit committee independence and quality of financial reporting

Table 4.41: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
With moderator	.764 ^a	.584	.564	2.1288325941
Without moderator	.352 ^a	.124	.104	3.0529583647

a. Predictors: (Constant), Audit committee Independence* system automation and staff competence, Audit committee Independence

According to ANOVA results for moderation effect of system automation and staff competence on the relationship between audit committee independence and quality of financial reporting, the F-statistic with the moderator variable is 30.139, which is greater than the F-critical of 3.000. The ANOVA also showed that the F change was significant at the 0.05 level. This implied that the coefficients in the model were not equal to zero and showed good model fitness. Abdallah (2013) reported that computerized accounting systems automate the accounting process thus improving efficiency and cutting down costs as it tends to be more accurate, faster to use, and less subject to error than its manual counterpart.

Table 4.42: ANOVA Results

Model		Sum of Squares	Df	Mean Square	F	Sig.
With moderator	Regression	273.176	2	136.588	30.139	.000 ^b
	Residual	194.873	43	4.532		
	Total	468.048	45			
Without moderator	Regression	57.944	1	57.944	6.217	.016 ^b
	Residual	410.104	44	9.321		
	Total	468.048	45			

a. Dependent Variable: Ratio of queried Transactions to Annual Budget

b. Predictors: (Constant), Audit committee Independence* system automation and staff competence, Audit committee Independence

The regression coefficient results showed that the coefficient of the moderating variable, Audit committee Independence* system automation and staff competence was 0.561. The coefficient on the interaction variable was also significant since its p-value was 0.000 which was less than 0.05. Since the coefficient of Audit committee Independence* system automation and staff competence was significant, it further implied that the system automation and staff competence significantly moderated the relationship between Audit committee Independence and quality of financial reporting measured by the ratio of queried transactions to annual budget. Similarly, Ismail a King (2007) recommended focusing on the development of the devices used in the department, train and development of the staff enable them to continue to perform their jobs and improve the quality of financial statements in the department

Table 4.43: Regression coefficient

		B	Std. Error	Beta	t	Sig.
With moderator	(Constant)	4.711	1.318		3.575	0.001
	Audit committee Independence	-4.193	0.54	-1.008	-7.757	0.000
	Audit committee Independence* system automation and staff competence	-0.561	0.116	-0.626	-4.817	0.000
Without moderator	(Constant)	7.876	2.702		2.914	0.006
	Audit committee Independence	-2.073	0.832	-0.352	-2.493	0.016

a Dependent Variable: Ratio of queried Transactions to Annual Budget

4.11.2 Moderating effect of system automation and staff competence on relationship between audit committee diversity and quality of financial reporting

The study also assessed the moderating effect of system automation and staff competences on the relationship between audit committee diversity and quality of financial reporting. According to the results, the value of R square without consideration of the system automation and staff competence was 15.3%. The R square improved to 45.0% when the system automation and staff competence was considered. This implied that system automation and staff competence positively enhanced the relationship between audit committee diversity and quality of financial reporting measured by ratio of queried transactions to annual budget. A study by Indira (2008) further pronounced the improvement in business performance as a result computerization of the accounting systems as it is a highly integrated application that transforms the business processes with the performance enhancing features which encompass accounting, inventory control, reporting and statutory processes. He added that, this may help the company access information faster and takes quicker decisions as it also enhances communication.

Table 4.44: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
With moderator	.671a	0.45	0.424	2.446641
Without moderator	.392a	0.153	0.134	3.001086

a Predictors: (Constant), Audit Committee Diversity* automation and staff qualification, Audit committee Diversity

According to the results, the F-statistic with the moderator variable is 17.595, which is greater than the F-critical of 3.000. The ANOVA also showed that the F change was significant at the 0.05 level. This implied that the coefficients in the model were not equal to zero and showed good model fitness.

Table 4.45: ANOVA Results

		Sum of Squares	df	Mean Square	F	Sig.
with moderator	Regression	210.648	2	105.324	17.595	.000b
	Residual	257.4	43	5.986		
	Total	468.048	45			
Without moderator	Regression	71.762	1	71.762	7.968	.007b
	Residual	396.287	44	9.007		
	Total	468.048	45			

a Dependent Variable: Ratio of queried Transactions to Annual Budget

b Predictors: (Constant), Audit committee Diversity*automation, Audit committee Diversity

The regression coefficient results showed that the coefficient of the moderating variable, Audit committee diversity*system automation and staff competence was 0.576. The coefficient on the interaction variable was also significant since its p-value was 0.000 which was less than 0.05. Since the coefficient of Audit committee

diversity* system automation and staff competence was significant it further implied that the system automation and staff competence significantly moderated the relationship between audit committee diversity and quality of financial reporting measured by the ratio of queried transactions to annual budget. Similarly, Ismail a King (2007) recommended focusing on the development of the devices used in the department, training and development of the staff enable them to continue to perform their jobs and improve the quality of financial statements in the department.

Table 4.46: Regression Coefficient

		B	Std. Error	Beta	t	Sig.
With moderator	(Constant)	2.203	1.127		1.955	0.057
	Audit committee Diversity	-3.338	0.563	-1.17	-5.932	0.000
	Audit Committee Diversity*system automation and staff competence	0.576	0.12	0.95	4.817	0.000
Without moderator	(Constant)	2.46	1.381		1.781	0.082
	Audit committee Diversity	-1.117	0.396	-0.392	-2.823	0.007

a Dependent Variable: Ratio of queried Transactions to Annual Budget

4.11.3 Moderating effect of system automation and staff competence on relationship between financial competence of audit committee members and quality of financial reporting

The study used regression analysis to test the moderating effect of system automation and staff competences on relationship between financial competence of audit committee members and quality of financial reporting. According to the results, the value of R square without consideration of the system automation and staff competence was 18.1%. The R square improved to 43.0% when the system automation and staff competence was considered. This implied that system

automation and staff competence positively enhanced the relationship between audit committee members financial competence and quality of financial reporting measured by ratio of queried transactions to annual budget. Similarly, Ismail a King (2007) recommended focusing on the development of the devices used in the department, training and development of staff to enable them to continue to perform their jobs and improve the quality of financial statements in the department.

Table 4.47: Model summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate
With moderator	.656a	0.43	0.403	2.491172
Without moderator	.425a	0.181	0.162	2.951701

a Predictors: (Constant), Audit committee Financial Competence, Audit committee Financial Competence* automation and staff qualification

According to the results, the F-statistic with the moderator variable is 16.21, which is greater than the F-critical of 3.000. The ANOVA also showed that the F change was significant at the 0.05 level. This implied that the coefficients in the model were not equal to zero and showed good model fitness.

Table 4.48: ANOVA Results

		Sum of Squares	df	Mean Square	F	Sig.
With moderator	Regression	201.193	2	100.597	16.21	.000b
	Residual	266.855	43	6.206		
	Total	468.048	45			
Without moderator	Regression	84.697	1	84.697	9.721	.003b
	Residual	383.352	44	8.713		
	Total	468.048	45			

a Dependent Variable: Ratio of queried Transactions to Annual Budget

b Predictors: (Constant), Audit committee Financial Competence, Audit committee Financial Competence*automation

The regression coefficient results showed that the coefficient of the moderating variable, Audit committee members financial competence*system automation and staff competence was 0.725. The coefficient on the interaction variable was also significant since its p-value was 0.000 which was less than 0.05. Since the coefficient of Audit committee members financial competence*system automation and staff competence was significant it further implied that the system automation and staff competence significantly moderated the relationship between Audit committee members financial competence and quality of financial reporting measured by the ratio of queried transactions to annual budget. A study by Indira (2008) further pronounced the improvement in business performance as a result computerization of the accounting systems as it is a highly integrated application that transforms the business processes with the performance enhancing features which encompass accounting, inventory control, reporting and statutory processes. He added that, this may help the company access information faster and takes quicker decisions as it also enhances communication.

Table 4.49: Regression Coefficient

		B	Std. Error	Beta	t	Sig.
With moderator	(Constant)	1.907	1.176		1.621	0.112
	Audit committee Financial Competence *automation	-	0.143	-	-	0
	Audit committee Financial Competence	0.725	0.143	1.067	5.059	0
Without moderator	(Constant)	4.003	0.707	1.195	5.665	0
	(Constant)	7.748	2.135		3.63	0.001
	Audit committee Financial Competence	-	0.52	-	-	0
	Competence	1.622	0.52	0.425	3.118	0.003

a Dependent Variable: Ratio of queried Transactions to Annual Budget

4.11.4 Moderating effect of system automation and staff competences on relationship between audit committee meetings and quality of financial reporting

Finally the study determined the moderating effect of system automation and staff competence on relationship between audit committee meetings and quality of financial reporting. According to the results, the value of R square without consideration of the system automation and staff competence was 20.4%. The R square improved to 21.6% when the system automation and staff competence was considered. This implied that system automation and staff competence positively enhanced the relationship between audit committee meetings and quality of financial reporting measured by ratio of queried transactions to annual budget.

Table 4.50: Model summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate
With moderator	.465a	0.216	0.18	2.920616
Without moderator	.451a	0.204	0.186	2.910212

a Predictors: (Constant), Audit committee Meetings, Audit Committee Meetings* automation and staff qualification

According to the results, the F-statistic with the moderator variable is 5.935, which was greater than the F-critical of 3.000. The ANOVA also showed that the F change was significant at the 0.05 level. This implied that the coefficients in the model were not equal to zero and showed good model fitness.

Table 4.51: ANOVA Results

		Sum of Squares	df	Mean Square	F	Sig.
With moderator	Regression	101.259	2	50.629	5.935	.005b
	Residual	366.79	43	8.53		
	Total	468.048	45			
Without moderator	Regression	95.398	1	95.398	11.26	.002b
	Residual	372.651	44	8.469	4	
	Total	468.048	45			

a Dependent Variable: Ratio of queried Transactions to Annual Budget

b Predictors: (Constant), Audit committee Meetings, Audit Committee Meeting*system automation and staff competences

The regression coefficient results showed that the coefficient of the moderating variable, Audit committee meetings*system automation and staff competence was 0.195. The coefficient on the interaction variable was insignificant since its p-value was 0.412 which was greater than 0.05. Since the coefficient of Audit committee meetings*system automation and staff competence was insignificant it implied that the system automation and staff competence did not moderate the relationship between Audit committee meetings and quality of financial reporting measured by the ratio of queried transactions to annual budget.

Table 4.52: Regression Coefficient

		B	Std. Error	Beta	t	Sig.
With moderator	(Constant)	6.18	2.918		2.118	0.04
	Audit Committee Meetings*system automation and staff competences	-0.195	0.235	-0.353	-0.829	0.412
	Audit committee Meetings	0.431	1.574	0.117	0.274	0.785
Without moderator	(Constant)	7.908	2.035		3.886	0
	Audit committee Meetings	-1.669	0.497	-0.451	-3.356	0.002

a Dependent Variable: Ratio of queried Transactions to Annual Budget

4.11.5 Moderated Multiple Regression Model

The study conducted a multiple regression model with the moderating variable as the independent variables to test the joint moderating effect of system automation and staff competence on the relationship between audit committees on quality of financial reporting in non-commercial state corporations in Kenya.

Table 4.53: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.890	0.793	0.767	0.41613

The results in Table 4.53 indicated that jointly all the independent variables in the model accounted for 79.3% of the variation in number of queried transactions which was adopted as a measure of quality of financial reports in non-commercial state corporations.

Table 4.54: ANOVA Results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	26.493	5	5.299	30.598	.000
	Residual	6.927	40	.173		
	Total	33.420	45			

The finding of ANOVA presented in Table 4.54 clearly shows that the model was statistically significant since the f-statistics =30.598, p=0.000 was significant at 0.05 significance level.

Table 4.55: Regression Coefficient

	β	Std. Error	t	Sig.
(Constant)	0.118	0.431	0.275	0.785
Audit committee Independence	-0.042	0.13	-0.324	0.747
Audit committee Diversity	-0.273	0.126	-2.16	0.037
Audit committee Finance Competence	-0.246	0.121	-2.034	0.049
Audit committee Meetings	-0.536	0.117	-4.574	0.000
System automation and staff competence	-0.044	0.127	-0.348	0.729

The results presented in Table 4.55 shows that when the moderating variable was included in the model, the relationship between audit committee independence and the ratio of queried transactions was negative and insignificant ($\beta=-0.042$, p=0.747). Therefore, the finding leads to the conclusion that in the moderated multiple regression model, system automation and staff competence did not significantly moderate the relationship between audit committee independence and quality of financial reports.

However, audit committee diversity, Audit committee Finance Competence and Audit committee Meetings were found to have a negative and significant relationship with quality of financial even after the introduction of the moderating variable (system automation and staff competence). Therefore, the study concluded that system automation and staff competence significantly moderated the relationship between audit committee diversity, audit committee finance competence, audit committee meetings and quality of financial reports.

4.12 Hypotheses Testing

4.12.1 Hypothesis One: Audit Committee Independence and Quality of Financial Reporting

H₀₁: Audit committee independence has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

The results of ANOVA test showed that the F value is 6.217 with a significance of p value = 0.016 which is less than 0.05, which means that the null hypothesis was rejected and concluded that there is a relationship between audit committee independence and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The coefficient $\beta = -2.073$ was also significantly different from 0 with a p-value=0.016 which was less than 0.05. The results implied that a unit change in audit committee independence will result in -2.073 units change in ratio of queried transactions to annual budget. This confirmed that there is a significant negative linear relationship between audit committee independence and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implies improved quality of financial reporting

therefore these findings further implied that increase in audit committee independence was found to result to increase in quality of financial reporting hence the null hypothesis that there is no significant relationship between audit committee independence and quality of financial reporting in non-commercial state corporations in Kenya was rejected.

Ghafran (2013) conducted a study on audit committees and financial reporting quality in the context of a large sample of UK companies over the period 2007-2010. The author found that independent audit committees exert a significant positive impact on the quality of reported earnings. Madakawi (2012) recommended that regulatory bodies in Nigeria should mandate all the three board representatives on audit committee to be non-executive directors, while making a combination of financial and industrial expertise replace financial literacy to further improve the quality of the financial reporting.

4.12.2 Hypothesis Two: Audit Committee diversity and Quality of Financial Reporting

H₀₂: Audit committee diversity has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

The results of ANOVA test show that the F value was 7.968 with a significance of p value = 0.007 which is less than 0.05, meaning that the null hypothesis was rejected and concluded that there is a relationship between audit committee diversity and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The coefficient $\beta = -1.117$ was significantly different from 0 with a p-value=0.007 which was less than 0.05. The results imply

that a unit change in audit committee diversity will result in -1.117 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee diversity and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implies improved quality of financial reporting therefore these findings further implied that increase in audit committee diversity was found to result to increase in quality of financial reporting hence the null hypothesis that there is no significant relationship between audit committee diversity and quality of financial reporting in non-commercial state corporations in Kenya was rejected. Huse and Solberg (2006) also found that female directors are better prepared for board meetings than male directors which results in improved board behaviour and effectiveness. These benefits should also be realized by audit committees with female membership. Deloitte (2014) report on board practices found marginal evidence of generational diversity in boardrooms, with so-called “younger” directors being in their fifties. The report suggested that while older directors do provide a wealth of knowledge, having younger directors introduces a fresh perspective into the boardroom which should not be underestimated.

4.12.3 Hypothesis Three: Audit Committee Members Financial competence and Quality of Financial Reporting

H₀₃: Audit committee members’ financial competence has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

The results of ANOVA test show that the F value was 9.721 with a significance of p value = 0.003 which was less than 0.05, meaning that null hypothesis was rejected

and concluded that there is a relationship between audit committee members financial competence and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The coefficient $\beta = -1.622$ was significantly different from 0 with a p-value=0.003 which was less than 0.05. The results imply that a unit change in audit committee financial competence will result in -1.622 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee members' financial competence and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these findings further implied that increase in audit committee members' financial competence was found to result to increase in quality of financial reporting. The null hypothesis that there was no significant relationship between financial competence of audit committee members and quality of financial reporting in non-commercial state corporations in Kenya was rejected. Similarly, Agung (2015) study implied that the member background in terms of education and experience influences their focus in the committee's activities. The study recommended that it is wise to include members in audit committee who have expertise and knowledge in accounting and auditing because most of the responsibilities of the committee are related to these areas.

4.12.4 Hypothesis Four: Conduct of Audit Committee Meetings and Quality of Financial Reporting

H0₄: Conduct of Audit committee meetings has no significant effect on quality of financial reporting in non-commercial state corporations in Kenya.

The results of ANOVA test show that the F value was 11.264 with a significance of p value = 0.002 which was less than 0.05, meaning that null hypothesis was rejected and concluded that there is a relationship between audit committee meetings and quality of financial reporting (ratio of queried transactions to annual budget) of non-commercial state corporations in Kenya. The coefficient $\beta = -1.669$ was significantly different from 0 with a p-value=0.002 which was less than 0.05. The results imply that a unit change in audit committee meetings will result in -1.669 units change in ratio of queried transactions to annual budget. This confirmed that there was a significant negative linear relationship between audit committee meetings and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these findings further implied that increase in audit committee meetings was found to result to increase in quality of financial reporting. The null hypothesis that there was no significant relationship between audit committee meetings and quality of financial reporting in non-commercial state corporations in Kenya was rejected. Stewart (2007) shared similar views by stating that increasing the frequency of committee meetings leads to more effective audit committees, therefore committee members ought to be willing to devote more of their time for auditing. Morrissey (2000) also suggested at least four

meetings in a year for audit committees. He further claims that the best quality of financial reports can be assured, if at least four sittings are held during the year.

4.12.5 Hypothesis Five: moderating effect of System automation and staff competences

H0₅: System automation and staff competences do not significantly moderate the relationship between audit committee and quality of financial reporting in non-commercial state corporations in Kenya.

The coefficient on the interaction variable was significant since its p-value was less than 0.05 for Independence, Diversity and Financial Competence. Since the coefficient of Audit committee Independence, Diversity, Financial Competence*System automation and staff competence was significant, it implied that the system automation and staff competences significantly moderated the relationship between Audit committee Independence, Audit committee diversity, Audit committee members financial competence and quality of financial reporting measured by the ratio of queried transactions to annual budget. The coefficient on the interaction variable was insignificant for relationship between audit committee meetings since its p value was 0.412 which was greater than 0.05. Since the coefficient of Audit committee meetings*system automation and staff competence was insignificant it implied that the system automation and staff competence did not moderate the relationship between audit committee meetings and quality of financial reporting measured by the ratio of queried transactions to annual budget.

The null hypothesis was rejected for the moderating effect of system automation and staff competence on the relationship between audit committee independence, audit committee diversity, audit committee members financial competence and quality of financial reporting while it was accepted for the moderating effects of system automation and staff competence on the relationship between audit committee meetings and quality of financial reporting. Buys, (2008) also found the use of accounting systems and automation of accounting process enhances financial reporting while having professional accountants ensures that proper bookkeeping and recording is done and therefore may also enhance quality of financial reporting.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of research findings on response rate, the general background information, the statistical analysis of specific objectives/research hypotheses. The summary of the major findings was presented based on the specific research objective. The conclusions and recommendations relating to specific objectives as well as suggestions for further research were highlighted.

5.2 Summary of Findings

Audit committees have a long standing and important role in the governance framework of public sector entities. They are recognized as a valuable provider of independent assurance and advice to the responsible authority on key aspects of an entity's operations. This study sought to establish the effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya. Specifically the study examined the effect of audit committee independence, audit committee diversity, audit committee financial competence and audit committee meetings on quality of financial reporting in non-commercial state corporations in Kenya. The study also sought to test the moderating effects of system automation and staff competences on the relationship between audit committee and quality of financial reporting in non-commercial state corporations in Kenya.

The study was founded on agency theory, Stewardship theory, policeman theory, lending credibility theory, theory of rational expectations and stakeholder theory. The study assessed previous literature conducted in this area which enabled in development of the conceptual model that the study intended to validate.

The study adopted a positivism philosophy. Positivists believe that reality is stable and that it can be described from an objective viewpoint, without interfering with the phenomena being studied. The study further employed descriptive research design. This study comprised of seventy two (72) state corporations that existed in 2006/2007 financial year from which the target population was drawn. The respondents comprised of top level employees in the audit department of the non-commercial state corporations. This category was chosen because of their expected proximity to confidential information about audit committee members qualifications and experience as well as general operations of the audit committee. A sample of one (1) employee from every non-commercial state corporation was selected to be the respondents who were issued with a questionnaire to respond to research statements.

Questionnaires were used to obtain primary data of the study variables. Annual budgets and value of queried transactions were obtained from the Finance Bill and the annual report of the Auditor General respectively of the respective financial years. These two sets of secondary data were used to compute ratio of queried transactions to annual budget of the state corporations. The models were tested on how well they fit the data and at the same time the significance of each independent variable was tested using Fischer distribution test, F-test and beta coefficient at 95% confidence level.

5.2.1 Audit Committee Independence and Quality of Financial Reporting

The study sought to determine the relationship between audit committee independence and quality of financial reporting which was measured by the ratio of queried transactions to annual budget. The correlation test results revealed a negative and significant association between audit committee independence and quality of financial reporting measured by the ratio of queried transaction in non-commercial state corporations in Kenya. The findings implied that increase in the audit committee independence reduces the ratio of queried transactions which further imply increase in the quality of financial reporting.

The regression analysis for audit committee independence and ratio of queried transactions to annual budget revealed that audit committee independence explained significantly variations in the ratio of queried transactions to annual budget. The finding further confirmed that there is a significant negative linear relationship between audit committee independence and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implies improved quality of financial reporting therefore these findings further implied that increase in audit committee independence was found to result to increase in quality of financial reporting. The null hypothesis that there is no significant relationship between audit committee independence and quality of financial reporting in non-commercial state corporations in Kenya was rejected.

5.2.2 Audit Committee Diversity and Quality of Financial Reporting

The study also sought to establish the effect of audit committee diversity on quality of financial reporting in non-commercial state corporations in Kenya. The findings implied that the respondents felt that the audit committees in non-commercial state corporations were diversified in terms of members' age group, tenure, gender and regional representation. The findings of correlation analysis showed that audit committee diversity had a negative and significant association with quality of financial reporting measured by the ratio of queried transactions to annual budget. The results implied that increasing diversity was found to have positive effects on quality of financial reporting since it reduced the ratio of queried transactions to annual budget.

A regression analysis was conducted with audit committee diversity as the independent variable and the ratio of queried transactions to annual budget as the dependent variable. The model summary result indicated that audit committee diversity explained a significant degree of the variation in the ratio of queried transactions to annual budget. The regression results confirmed that there was a significant negative linear relationship between audit committee diversity and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The results imply that a unit change in audit committee diversity will result in a negative change in ratio of queried transactions to annual budget.

This confirmed that there was a significant negative linear relationship between audit committee diversity and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried

transactions to annual budget implies improved quality of financial reporting therefore these findings further implied that increase in audit committee diversity was found to result to increase in quality of financial reporting. The null hypothesis that there is no significant relationship between audit committee diversity and quality of financial reporting in non-commercial state corporations in Kenya was rejected.

5.2.3 Audit Committee Financial Competence and Quality of Financial Reporting

The study further sought to determine the relationship between financial competence of audit committee members and quality of financial reporting. Financial competence was measured using financial training, knowledge in accounting matters, financial reporting experience and knowledge of governance and risk management whereas the study measured quality of financial reporting using the ratio of queried transaction to annual budget of non-commercial state corporations in Kenya.

The findings of correlation analysis showed that audit committee financial competence had a negative and significant association with ratio of queried transaction to annual budget. The results implied that increasing financial competence was found to have positive effects on quality of financial reporting since it reduced the ratio of queried transactions to annual budget. The study employed regression model to ascertain the relationship between audit committee members financial competence and quality of financial reporting. This confirmed that there was a significant negative linear relationship between audit committee financial competence and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these

findings further implied that increase in audit committee financial competence was found to result to increase in quality of financial reporting. The null hypothesis that there was no significant relationship between financial competence of audit committee members and quality of financial reporting in non-commercial state corporations in Kenya was rejected.

5.2.4 Conduct of Audit Committee Meetings and Quality of Financial Reporting

The fourth objective of this study intended to establish the effects of conduct of audit committee meetings on the quality of financial reporting in non-commercial state corporations. The correlation results showed that audit committee meetings had a negative and significant association with ratio of queried transaction to annual budget. The results implied that increasing the number, frequency, relevance of agenda and attendance of audit committee meetings was found to have positive effects on quality of financial reporting since it reduced the ratio of queried transactions to annual budget.

The study also employed regression model to ascertain the relationship between audit committee meetings and quality of financial reporting. Regression results confirmed that there was a significant negative linear relationship between audit committee meetings and ratio of queried transactions to annual budget of non-commercial state corporations in Kenya. The reduction in the ratio of queried transactions to annual budget implied improved quality of financial reporting therefore these findings further implied that increase in audit committee meetings was found to result to increase in quality of financial reporting. The null hypothesis that there was no

significant relationship between audit committee meetings and quality of financial reporting in non-commercial state corporations in Kenya was rejected.

5.2.5 Moderating Effect of System automation and staff competences

This study sought to examine the moderating effect of system automation and staff competences on the relationship between audit committees and quality of financial reporting in non-commercial state corporations in Kenya. The findings revealed that system automation and staff competences significantly moderated the relationship between Audit committee Independence, Audit committee diversity, Audit committee members' financial competence and quality of financial reporting measured by the ratio of queried transactions to annual budget. Since the coefficient of Audit committee meetings*system automation and staff competence was insignificant, it implied that the system automation and staff competence did not moderate the relationship between Audit committee meetings and quality of financial reporting measured by the ratio of queried transactions to annual budget.

5.3 Conclusion

The study concluded that audit committee independence significantly influenced the quality of financial reporting. Based on these findings the study concluded that an independent audit committee plays its role better as compared to non-independent committees and one benefit of this independence is to improve the quality of financial reporting. Inclusion of non-executive committee members ensures that there are no conflicts of interests hence ensuring shareholders' interests supersedes self-interests.

Based on the study findings, the study further concluded that audit committee diversity contributes significantly to quality of financial reporting. Diversity breeds multiple ideas originating from individuals of various points of view which ensure quality financial reporting is realized at the end. Organisations with diversified audit committees realize better financial reporting.

The study further concluded that audit committee members financial competence positively impacts on the quality of financial reporting. Competent individuals are key in identifying when the financial reports deviate from the quality standards. Finally this study also concluded that having quality and optimal number of meetings by the audit committees improves quality of financial reporting. This is achieved when the attendance is good, agenda is relevant and the number of meetings is optimal.

From the findings, the study concluded that audit committees should have high level of independence, diversity, financial competence and quality meetings in order to execute their roles and mandate effectively. This will enhance the quality of financial reporting. The primary objective of financial reporting is to provide high-quality financial information concerning economic entities, primarily financial in nature but which is useful for economic decision making.

This study further contributed to the bridging of the theoretical gaps on the effect of audit committee characteristics on quality of the financial reporting and confirmed that audit committee characteristics significantly influenced quality of financial reporting.

5.4 Recommendations of the Study

In policy making, the study recommends that policy makers in national and county governments should legislate on the independence of audit committees in state corporations. It must be mandatory for State Corporation to ensure at least a third of members in audit committees are non-executives. Similarly policies should be formulated to regulate audit committees financial competence, ensure diversity and meetings.

5.4.1 Audit Committee Independence

Based on the findings of this study, the following recommendations were made; the study recommended that audit committees in non-commercial state corporations should be as independent as possible. Independence has been accepted as a good practice in corporate governance. In state corporations, audit committee members could be perceived as independent of the entity but this independence is usually eroded as they become affiliated with the management, and as a result they rely more and more on the financial rewards from the entity at the expense of committee effectiveness.

5.4.2 Audit Committee Diversity

This study also recommended that when constituting audit committees in state corporations, consideration should be put on diversity. Diversity of audit committees should be evaluated based on gender, age, geographical orientation and tenure. Audit committees should consist of diversified members. This because demographic diversity of audit committee influences the quality of firm's financial reporting.

5.4.3 Audit Committee Competence

The study also recommended that audit committees should consist of members with knowledge in accounting and finance which provides a good basis for audit committee members to examine and analyse financial information. The educational background becomes an important characteristic to ensure audit committees perform their roles effectively. The audit committee members who have accounting and auditing experience can play a leading role in the committee by providing valuable views, justification, and comments, which can increase a committee's productivity.

5.4.4 Conduct of Audit Committee Meetings

The study further recommended that audit committees should have frequent meetings since meetings play a significant role in mitigating various issues including the agency problem ultimately influencing the quality of financial reporting. Attendance of meeting should be emphasised while the agenda of the meetings should be geared towards improving financial reporting.

5.4.4 System automation and staff competence

Finally the study recommended that non-commercial state corporations should automate their systems and adopt the use of ICT in financial analysis and reporting. They are also required to engage qualified accountants in order to improve the quality of their financial reports.

5.5 Area for Further Research

This study focused on establishing the effect of audit committees on quality of financial reporting in non-commercial state corporations in Kenya. The study recommends that future studies should focus on establishing the effect of board characteristics on the quality of financial reporting in state corporations. The study also recommends that more characteristics of the audit committees could be studied to verify their effect on quality of financial reporting.

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APPENDICES

Appendix I. Questionnaire

INTRODUCTION

This study seeks to establish the Effect of Audit Committee Characteristics on Quality of Financial Reporting among Non-Commercial State Corporations in Kenya. You are requested to answer the questions as accurately and honestly as possible and your responses will greatly help in the study.

SECTION A: GENERAL AND DEMOGRAPHIC DATA

1. Please indicate the highest level of education you have attained
 - a) Polytechnic / College level ()
 - b) University level ()
 - c) Post graduate level ()
2. Cumulatively, how many years have you worked in non-commercial state corporations?
 - a) Less than 2 years ()
 - b) 3 to 5 years ()
 - c) Over 5 years ()
3. Kindly indicate your position in the company
 - a) Top level management staff
 - b) Middle Level management staff

SECTION B: AUDIT COMMITTEE INDEPENDENCE

This section aims to establish the effects of audit committee independence on the quality of financial reporting in non-commercial state corporations in Kenya. The statements are measured on likert scale. Kindly indicate your level of agreement with the statement. Tick as appropriate as 1= Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree.

S/No	Statements	1	2	3	4	5
1	Our audit committee has non-executive members.					
2	Selection of chairman in our audit committee is transparent					
3	Appointment of members in our audit committee is transparent					
4	Audit committee members have no relationship with top management					

Indicate the total number of audit committee members and the number of non-executive members of the committee in the following years.

Years	Total number of Audit Committee Members	number of non-executive members
2006/07		
2007/08		
2008/09		
2009/10		
2010/11		
2011/12		

SECTION C: AUDIT COMMITTEE DIVERSITY

This section aims to establish the effect of audit committee diversity on the quality of financial reporting in non-commercial state corporations in Kenya. The statements are measured on likert scale. Kindly indicate your level of agreement with the statement. Tick as appropriate as 1= Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree.

S/No	Statements	1	2	3	4	5
1	Our audit committee has members of different age groups					
2	Our audit committee has a diversified regional representation					
3	Audit committee members have different office tenure					
4	Our audit committee has both male and female members					

5. Indicate the numbers of female and male members and members who had similar tenure of service in the following years.

Years	Male Members	Female Members	Members with similar tenure
2006/07			
2007/08			
2008/09			
2009/10			
2010/11			
2011/12			

6. Indicate the numbers of audit committee members within the following age groups who served in the committee in the following years

	20-35 years	35-50 years	50-65 years	60 years and above
2006/07				
2007/08				
2008/09				
2009/10				
2010/11				
2011/12				

SECTION D: FINANCIAL COMPETENCE OF AUDIT COMMITTEE MEMBERS

This section aims to establish the effects of financial competence of audit committee members' on the quality of financial reporting in non-commercial state corporations in Kenya. The statements are measured on likert scale. Kindly indicate your level of agreement with the statement. Tick as appropriate as 1= Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree.

S/No	Statements	1	2	3	4	5
1	Our audit committee members have undertaken financial training					
2	Our audit committee members have knowledge in Accounting matters					
3	Audit committee members have financial reporting experience in audit and related fields					
4	Our audit committee members have knowledge of governance and risk management.					

SECTION D: CONDUCT OF AUDIT COMMITTEE MEETINGS

This section aims to establish the effect of audit committee meetings on the quality of financial reporting in non-commercial state corporations in Kenya. The statement are measured on likert scale kindly indicate your level of agreement with the statement. Tick as appropriate as 1= Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree.

S/No	Statements	1	2	3	4	5
1	Our audit committee hold meetings frequently					
2	The number of meetings held by the audit committee are adequate					

S/No	Statements	1	2	3	4	5
3	Our audit committee have relevant agenda during their meetings					
4	Audit committee members attend meetings regularly.					

Kindly indicate the numbers of meeting held by the audit committee in the following years and the number of attendance

Years	Number of Meetings
2006/07	
2007/08	
2008/09	
2009/10	
2010/11	
2011/12	

SECTION E: SYSTEM AUTOMATION AND STAFF COMPETENCES

This section aims to establish the effect of system automation and staff competence on the relationship between audit committee and quality of financial reporting in non-commercial state corporations in Kenya. The statements are measured on likert scale. Kindly indicate your level of agreement with the statement. Tick as appropriate as 1= Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree.

No	Statements	1	2	3	4	5
1	Our audit committee works with qualified accountants					
2	Our accountants have continuous professional training					
3	Our accounting process is automated					
4	Our entity has proper and modern book-keeping system					

Appendix II: Secondary Data Collection Template

Financial Year	Value of Queried Transactions (Kshs)	Annual Budget (Kshs)	Ratio of queried transactions to annual budget
2006/2007			
2007/2008			
2008/2009			
2009/2010			
2010/2011			
2011/2012			

Appendix III: List Of Non-Commercial State Corporations as at 2005

A. Regulatory

1. Betting Control and Licensing Board
2. Capital Markets Authority
3. Central Agricultural Board
4. Coffee Board of Kenya
5. Electricity Regulatory Board
6. Export Processing Zones Authority
7. Cotton Board of Kenya
8. Film Censorship Board
9. Horticultural Crops Development Authority
10. Hotels and Restaurants Authority
11. Kenya Bureau of Standards
12. Kenya Dairy Board
13. Kenya Plant Health Inspectorate Services
14. NGO Coordination Board
15. Pests Products Control Board
16. Pharmacy and Poisons Board
17. Pyrethrum Board of Kenya
18. Radiation Protection Board
19. Sisal Board of Board
20. Tea Board of Kenya
21. Kenya Tea Development Authority
22. Communications Commission of Kenya
23. Presidential Commission on Soil Conservation
24. Kenya Sugar Authority
25. National Environment Management Authority

B. Research institutes

1. Coffee Research Foundation
2. Kenya Agricultural Research Institute
3. Kenya Forestry Research Institute
4. Kenya Industrial & Research Development Institute
5. Kenya Institute for Public Policy Research & Analysis
6. Kenya Marine and Fisheries Research Institute
7. Kenya Medical Research Institute
8. Kenya Trypanosomiasis Research Institute
9. Tea Research foundation
10. Kenya Veterinary vaccines Production Institute

C. Educational/Professional

1. Cooperative College of Kenya
2. Council of Legal Education
3. Egerton University
4. Higher Education Loans Board
5. Jomo Kenyatta University of Agriculture and Technology

6. Kenya Institute of Administration
7. Kenya Medical Training Center
8. Kenya National Examinations Council
9. Kenya Utalii College
10. Kenyatta University
11. Moi University
12. University of Nairobi
13. National Council for Science and Technology
14. Maseno University

D. Development/Promotional agencies

1. Coast Development Authority
2. Ewaso Ng'iro North River Basin Development Authority
3. Ewaso Ng'iro South River Basin Development Authority
4. Kerio Valley Development Authority
5. Lake Basin Development Authority
6. National Irrigation Board
7. Tana Athi Rivers Development Authority
8. Export Promotion Council
9. Investment Promotion Center
10. Kenya Tourism Board
11. Kenya Wildlife Service

E. Culture/Social service

1. Kenya National Library Services
2. Kenyatta National Hospital
3. Local Authorities Provident Fund
4. Moi Referral and Teaching Hospital
5. National Hospital Insurance Fund
6. National Social Security Fund
7. Presidential Music Commission
8. Bomas of Kenya Ltd.
9. National Museums of Kenya
10. National Aids Control Council

F. Revenue collection

1. Catering Levy Trustees
2. Kenya Revenue Authority