



Influence of Audit Committee Independence on the Quality of Audit Reports of Sacco's in Homabay County, Kenya

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Abstract

Every operating organization keeps tabs on its development by producing accurate financial statements at the conclusion of each fiscal year, which are subsequently distributed to various individual users who are concerned with the organization's development. The accuracy of the financial accounts is then verified by an audit procedure, which is sealed by a transparent audit report provided to the specific business by the audit committee. The main objective of this study was to examine the influence of audit committee independence on the quality of audit reports of Sacco's in Homabay County, Kenya. This was supported by the fact that there are numerous Sacco's in Homabay County, many of which had apparently experienced audit problems in the past. Stakeholders' theory served as the study's compass. This study adopted a descriptive causal research design, the target population was 104 audit committee members of deposit taking Sacco's in Homabay County as at December 2021. Out of the target population determined using the Krejcie and Morgan formula, 82 members of the audit committee provided responses for the study. Primary data was collected using research questionnaire which involved drop and pick method. Descriptive statistics including a frequency table, mean, and standard deviation were used for data analysis while inferential statistics included Pearson's correlation analysis. The study found that audit committee independence in Homabay County, Kenya, had a positive and significant impact on the caliber of audit reports on Sacco's ($r=0.530$, $p<0.05$). The study recommends that Sacco's audit committee members should be as independent as possible in executing their mandate so as to ensure audit reports provided are of quality.

Keywords: Audit Committee Independence, Quality of Audit Reports, Deposit taking Sacco's.

1. Introduction

The text is to be typeset in 11 pt Times Roman, single spaced. The Introduction should argue the case for the study, outlining only essential background, and should not include the findings or the conclusions. It should not be a review of the subject area, but should finish with a clear statement of the question being addressed.

The relationship between audit quality and audit committee independence is still a hotly debated topic that has been studied by numerous investigators. A completely independent audit committee lessens the use of earnings management strategies, according to study by Sayed and Takiah, (2017). Additionally, it was discovered that companies owning more experienced audit committee participants and audit committee sessions recorded fewer earnings management methods than other companies. This study amply demonstrated that there exists a favorable match between the audit quality and audit committee independence. Additionally, this study was convincing enough to show that the makeup of a committee could influence the predicted type of financial report.

The oversight panel of board of directors entails managing the process for financial reporting, choosing impartial auditors, and obtaining the findings of both internal and external audits (Durand, 2019). According to Nuraddeen and Hasnah (2015), the auditors' capacity to identify and reveal significant omissions and manipulations of reported net income is referred to as audit quality. The main responsibilities of an audit committee in any organization is to closely check on every step of the financial reporting process, the internal control framework, and to ensure legal and regulatory compliance (Temple, 2019).

1.1. Problem Statement

A number of Sacco's experience an employee turnover challenge since those recommended by the board do not perform to the expectation of the Sacco. The 2014 report equally unearthed that Good faith Sacco society Limited in Kajiado encountered various shortcomings with their audits being that the audit committee colluded severally with the Sacco's management to skew the report in their favor. Similarly, SASRA's 2016 report posits that Harambee Sacco Society Limited in Nairobi encountered reduced performance which was attributed to inaccurate audit report.

SASRA's 2017 report opines that Jitegemee Sacco Society Limited in Mombasa experienced serious collisions from outsiders in the Sacco's affairs including the audit practice. This affected the quality of the report since it lacked independence. 2020 report revealed that Rachuonyo Teachers Sacco Society Limited in Oyugis, opted for outsourcing auditors which seemed costly with high remunerations pegged to the process. The audit report did not touch on serious issues since the committee needed to protect their positions. Future researchers are advised by Alex and Stephen (2019) to focus heavily on audit independence in order to increase stakeholders' perceptions of sustainability.

1.2. Research Objectives

To examine the influence of audit committee independence on quality of audit reports on Sacco's in Homabay County, Kenya.

1.3. Research Hypothesis

HO1: Audit committee independence has no significant influence on the quality of audit report of Sacco's within Homabay County, Kenya.'

2. Literature Review

2.1. Stakeholders Theory

This theory is a brain child of one academician Edward Milton Freeman of 1984, from University of Chicago as postulated by Alex and Stephen, (2019). The theory opines that for any business to be successful, it has to create value for customers, suppliers, employees, communities and financiers alongside other stakeholders. It bases its functionality on the assumption that business can only be considered successful when they deliver value to the majority of their stakeholders (Anthony, 2018). The principle of stakeholder theory is defined by the fact that a company's leaders must understand and account for all their company's stakeholders' interests reigning supreme. Companies like Johnson and Johnson and Merck have successfully applied stakeholder theory to their satiety.

This theory is significant in a lot of studies, and particularly in this study it adds a lot of input. The separate auditors should maintain their independence to provide a free and unbiased assessment of the Sacco's financial position in order to maximize the value of the investments made by diverse stakeholders. The committee should also consider publishing an audit report which is free from material misstatements. In order to bring value, the committee should be made up of people having experience in auditing.

2.2. Conceptual Review

2.2.1. Audit Committee Independence

Institute of Internal Auditors (2011) defines independence as the conditions which enable organizations or auditing firms to carry out their tasks in an unbiased manner. Threats to auditing committee independence must be handled at the individual, functional, and organizational levels. Independent internal audit firms perform their duties more efficiently when they are free to advise management on how to maintain consistency in control policies. Both the Company's Act and the professional code of ethics stipulate that the auditor must be truly independent in order to carry out his or her responsibilities. Professional independence includes separation from the client, as well as mental, status, and outlook independence. It is a crucial professional trait because it allows the auditor to Oroudo (2019), notes that managers who use the internal audit functions for various extended roles disregard the importance of the independence of the audit committee.

The auditor's impartiality and independence are crucial components that raise the economic declaration's dependability and credibility. The auditor should use the appropriate defense techniques to identify financial frauds before they threaten independence (Puni and Anlesinya, 2020). The auditor should not perform any services without the consent of the client, and if he agrees to do so, he must choose a qualified assistant to help with the task. The use of auditing standards, satisfactory controlling, management pressure, and the provision of non-audit services are all impacted by the auditor's independence as well.

2.3. Empirical Review

2.3.1. Audit Independence and Quality Audit Report

According to Qeshtaa and Ali (2020), an audit committee is essential to maintaining the veracity of financial statement reporting. Indeed, the efficacy of an audit committee is based on its independence (Musallam, 2020). It is unlikely that auditors would manipulate financial reports from specific companies. If such manipulation takes place, it can only be a result of a lack of honesty and responsibility on the part of the committee members. Independence increases the audit committee's autonomy and frees it from any conflicts of interest (Rahman, 2019). It is crucial to make sure the audit committee is composed of impartial, dependable, honest, and trustworthy people (Ashfaq, and Rui, 2019). The traits and make-up of the audit committee have a big impact on how financially successful Sacco's are. The audit committee must be made up of individuals with the required minimum requirements.

A study by Stewart and Subramanian (2010), the researchers used a literature review methodology and empirical data from across Europe to investigate how the internal auditor's functions affect the caliber and objectivity of the audit function. The study's conclusions showed that audit independence was a critical factor in determining objectivity within the audit functions and that it encouraged firms to produce better financial reporting. Audit Expectation Gap: Problems and Challenges was evaluated by Arena and Jespersen, (2016). The investigation covered the whole Nigerian public sector. The study used a normative, descriptive approach to analyze the data, and it came to the conclusion that the way users perceived the job of auditors contributed to the creation of a quality report.

Mwangi (2018), investigated on the relationship between auditors and clients. The researcher examined the discrepancies between board members' and auditors' expectations regarding the factors influencing clients' choice of auditor. Targeting partners and senior managers at audit firms, the study used a survey research design. A sample of 32 board members and 41 partners and senior partners from audit firms were used in the study to gather research data. Both descriptive and inferential analysis were used in the study. The study's findings suggest that the auditor's independence and the audit's overall quality had a beneficial impact on the firm's expectation gap. The audit fees, auditor connection, and expectation gap were not shown to significantly interact in the study. The study examined audit firms in European nations, whereas the current study investigates the audit committee characteristics on the quality of audit reports.

3. Methodology

The association between the variables in this study was established using a descriptive causal research design. The study focused on deposit-taking Sacco's in Kenya's Homabay County. Eight Sacco's that were registered with the Homabay County Sacco Societies Regulatory Authority served as the study's unit of analysis. 104 members formed the target population where simple random sampling was employed to select 82 respondents. The key data used in this investigation involved both primary and secondary data. Primary data was gathered through the use of a self-administered questionnaire, primary data was gathered. The questioners used closed-ended, five-point Likert scale questions. One representing strongly disagree and five being strongly in agreement. Statistical methods and inferential were used in the data analysis. The answers to the questionnaires aided in acquiring a thorough understanding of how the audit committee's qualities affected the caliber of Sacco's' audit reports in Homabay County, Kenya.

4. Findings and Discussions

This section presents the results for the study. It covers the responses, reliability, descriptive, regression, conclusions and recommendations.

4.1. Respondents' background

Research questionnaires were presented and collected for analysis. The questionnaires administered were 82 and a sum total of 62 research questionnaires were properly filled and returned. The response rate outcome is shown in Table 1.

Table 1: Questionnaire Response Rate.

Response	Frequencies	Percent
Return	62	75.6%
Not return	20	24.4%
Total	82	100%

The questionnaire response rate achieved was 75.6% as indicated above. According to Kothari, (2004) questionnaire response rate above 50% sufficient and adequate for the study to proceed. Thus, in regards to these

assertions, the questionnaire response rate of 75.6% attained was adequately sufficient for the research study to proceed with examination.

4.2. Reliability

The outcome in Table 2 confirmed that the reliability results for all of the statements had been dependable for the reason that Cronbach alpha was above 0.7. Therefore, the inner consistency reliability was excellent.

Table 2: Coefficient of Reliability

Research Variable	N of Items	Cronbach's Alpha	Remarks
Audit committee independence	6	0.866	Accepted

Source Field data (2022)

The study variable depicted had Cronbach Alpha values above 0.7. The reliability data on table 2 above suggested that the Cronbach alpha value is more than the standard value of 0.7. This led to the conclusion that the questionnaire and its factors have been dependable in data collections for the foregoing study. Thus, the data collection instrument was dependable as mentioned by Muthanga and Odipo (2017).

4.3. Descriptive statistics on Audit Committee Independence

This assessed whether Audit Committee Independence can give a true reflection of quality audit reports and thus give valid information and advice that can guide quality audit reports of Sacco's. The responses are summarized in Table 3.

Table 3: Descriptive statistics: Audit Committee Independence

Statement	5	4	3	2	1
1 The audit committee is always committed to the disclosure of materials	11 (17.7)	34(54.8)	7(11.3)	5(8.1)	13(21)
2 It is always a preference of the board to have an outside director within the audit team	13(21)	38(61.3)	5(8.1)	4(6.5)	2(3.2)
3 The board always endeavors to ensure there is no conflict of interest among the audit committee members	10(16.1)	37(59.7)	6(9.7)	5(8.1)	4(6.5)
4 The audit committee always endeavor to ensure the members enjoy security tenure	9(14.5)	39(62.9)	5(8.1)	6(9.7)	3(4.8)
5 The board always endeavors to be transparent in their recruitment of audit committee members	11(17.7)	37(59.7)	4(6.5)	3(4.8)	7(11.3)
6 The audit committee always endeavors to adhere to the line of authority established in the committee	12(19.4)	30(48.4)	7(11.3)	7(11.3)	6(9.7)

Source Field data (2022)

From Table 2, most respondents agreed (54.8%) and strongly agreed (17.7%) that the audit committee is always committed to the disclosure of materials, implying that the management team engages external auditors to give an independent audit view of the company performance. Secondly, most respondents also agreed (61.3%) that there was a preference of the board to have an outside director within the audit team, implying that varied audit firms should give an independent overview of the company's audit status than relying on one company that can easily be compromised.

The board always endeavored to ensure there was no conflict of interest among the audit committee members as 59.7% of respondents agreed implying that independence was guaranteed in assessing quality audit reports. This was further supported by most respondents who agreed (62.9%) that the audit committee always endeavored to ensure the members enjoy security tenure, thus cannot compromise audit reports.

Further, most respondents agreed (17.7%) and strongly agreed (59.7%) that the board always endeavors to be transparent in their recruitment of audit committee members, most respondents agreed (48.4%) and strongly agreed (19.4%) that generally the audit committee always endeavors to adhere to the line of authority established in the committee. This findings agrees with Nyaga, Kiragu and Riro (2018) who examined the influence of internal audit independence on internal audit effectiveness in the Kirinyaga county government, Kenya and found audit

independence to be positive and significant. It further agrees with Harrison and Ochieng (2018), who conducted research on Internal Factors Influencing External Auditors Independence among Practicing Accountants in Kenya. On a contrary lane, Abdeljawad, Oweidat and Saleh (2020), found audit independence to be insignificant. However, the difference could arise from the target group as the current study is based on Sacco's unlike past study on Insurance firms.

4.4. Linear Regression for Audit committee independence

Table 4: Model Summary for Audit committee independence

Model Summary ^b									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	0.530 ^a	0.281	0.269	0.42999	0.281	23.450	1	60	0.000

a. Predictors: (Constant), Audit committee independence

b. Dependent Variable: Quality audit reports

Source: Field data, 2023

Linear regression results between Audit committee independence and quality of audit report. In the simple regression analysis, R is equivalent to the Karl Pearson correlation coefficient (r) was used to measure the relationship (Sekaran, 2003). Regression coefficient (B), analysis of variance (ANOVA) and t-test were used to test the hypotheses at 0.05 % significance level, with 95% confidence interval, which is acceptable in social sciences. The beta coefficient (β) is the degree of change in the outcome variable for every 1-unit of change in the predictor variable. R squared (R^2) is the coefficient of determination (the coefficient of multiple determination for multiple regression) and is the proportion of the variance in the dependent variable that is predictable from the independent variable. It is a measure of how close the data are to the fitted regression line.

A correlation coefficient (R) of 0.530 which implied that Audit committee independence had a strong positive association of quality of audit report for Sacco's in Homabay County. Audit committee independence accounted for 28.1% ($R^2 = 0.281$) deviations in the quality of audit report. These results signify that for every unit of change of 0.530 units in the quality of audit report, will be attributed to the Audit committee independence see in Table 5.

Table 5: ANOVA for Audit committee independence

ANOVA ^b						
Model	Sum of Squares	Df	Mean Square	F	Sig.	
1 Regression	4.336	1	4.336	23.450	0.000 ^a	
Residual	11.093	60	.185			
Total	15.429	61				

a. Predictors: (Constant), Audit committee independence

b. Dependent Variable: Quality audit reports

Source: Field data, 2023

H01: Audit committee independence has no significant influence on the quality of audit report of Sacco's within Homabay County, Kenya

The mean of Audit committee independence were regressed with mean of quality of audit report and the results are as shown in Table 4.8. Results show that Audit committee independence had a positive, linear and significant ($p \leq 0.05$) with the quality of audit report {regression coefficient, $B = 2.224$, $\beta = 0.530$, ANOVA, $F(23.450)$ and t-test value, $t = 7.472$ }.

Table 6: Coefficients for Audit committee independence

		Coefficients ^a			
		Unstandardized Coefficients		Standardized Coefficients	
	Model	B	Std. Error	Beta	T
1	(Constant)	2.224	0.298		7.472
	Audit committee independence	0.376	0.078	0.530	4.842

Source: Field data, 2022

4.4.1. Dependent variable: Quality audit reports

The first study tested the following null hypothesis:

The relationship between Audit committee independence and quality of audit report is strong as indicated by $B = 2.224$, $\beta = R = 2.224$, The test criterion was set such the study rejects the null hypothesis H_0 if $\beta_1 \neq 0$.

$$\begin{aligned} \text{Model: } Y &= \beta_0 + \beta_1 X_1 + \varepsilon \\ \text{Where } Y &= \text{quality of audit report,} \\ \beta_0 &= 2.224 \text{ (constant)} \\ \beta_1 &= 0.376 \\ X_1 &= \text{Audit committee independence} \\ \varepsilon &= \text{error term} \end{aligned}$$

Replacing in the equation above, the model becomes:

$$Y = 3.754 + 0.739X_1$$

Based on these results, the null hypothesis was rejected since a positive, linear and significant (p-value is less than 0.05) association between Audit committee independence and quality of audit report was established.

This findings concurs with Nyaga, Kiragu and Riro (2018) who examined the influence of internal audit independence on internal audit effectiveness in the Kirinyaga county government, Kenya and found audit independence to be positive and significant. It further agrees with Harrison and Ochieng (2018) who conducted research on Internal Factors Influencing External Auditors Independence among Practicing Accountants in Kenya. On a contrary lane, Abdeljawad, Oweidat and Saleh (2020), found audit independence to be insignificant. However the difference could arise from the target group as the current study is based on SACCOs unlike past study Insurance firms

5. Conclusion

This study concluded that audit committee independence have a significantly positive influence on quality of audit reports of Sacco in Homabay County. Similarly, Sacco's audit committee members should be as independent as possible in executing their mandate so as to ensure audit reports provided are of quality.

The study recommends that similar research should be done on other Sacco's in different areas. Other financial entities, such as banks and microfinance firms, can be the subject of similar research.

Lack of funding for the study, which was a significant drawback given Homabay County's extensive geographic location and the Sacco's' dispersed locations, was one of the study's primary weaknesses. Time was also a huge issue for me because I had to balance working on the research with my other tasks and obligations.

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