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Effect of The Size of Audit Committee on Internal Audit Effectiveness in Kericho and Nyandarua County Governments in Kenya

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Abstract

The study sought to determine the effects of audit committee characteristics on internal audit effectiveness in the county governments of Nyandarua and Kericho, Kenya. The study was confined to four independent variables, that is, size of audit committee, audit committee independence, audit committee financial expertise and audit committee management support. The study was guided by the Stakeholders Theory, the Agency Theory, and Institutional Theory. The study adopted a descriptive research design. The target population for this study comprised of internal audit staff, accountants and revenue officers of county executive and county assembly in the county government of Nyandarua and Kericho who number 35 and 32 respectively. The study adopted a census where all members were taken as respondents. Questionnaires were used to collect data after pilot testing. The questionnaires were pretested to ensure content validity and also for reliability at the recommended Cronbach alpha of 0.7. Data collected was analyzed using Statistical Package for Social Sciences (SPSS). The data collected was analyzed using both descriptive and inferential statistical methods. It is hoped that the findings of the study were beneficial to all stakeholders in the county governments. This would lead to the development of better practices to improve the management efficiency in the county governments. Findings indicated that the independent variables; size audit committee, audit committee independence had a positive significant relationship with internal audit effectiveness in Nyandarua and Kericho Counties. Based on the findings of the study, it was concluded that the size of audit committee, have significant influence on internal audit effectiveness in both counties. The study recommended that the county governments should ensures that the composition of audit members should clearly be spelt out to enable their functions effectively.

Introduction

Functions and responsibilities of audit committees can be guided and regulated by law or principles of corporate governance. In Netherlands, there were guidelines with regard to the scope, responsibilities and tasks of the audit committee; this applies to organizations that choose to have one. In 2012, the Ministry of Finance reviewed and added a new regulation of ministerial public sector audit (Hepworth & De Koning, 2012). In New Zealand's public sector, there are no laws or regulations governing audit committees but only pieces in the legislation of the Public Finance Act of 1989, the Crown Entities Act of 2004 and the Local Government Act of 2002 (Magrane & Malthus, 2010).

The accounting and auditing scandals throughout the world both in the public and private sector, has made the issue of an audit committee, audit firm and firm performance to become the subject of debate among politicians, business leaders, and regulators. The contents of reports on these scandals remain a source of worries for stakeholders. High profile scandals like the ones involving Enron and Worldcom in the US and Cadbury involved extensive fraud and falsification of contents financial statement (Al-Shaer et al., 2017).

There has been an emphasis that government ministries in Namibia should establish audit committees. The Public Accounts Committee (PAC) of Namibia in its recommended that the ministries and offices must establish audit committees. (Ihuhua, 2012). Currently in Namibia, the only document that governs audit committees in the private sectors and State-owned Entities (SOEs) is the Corporate Governance Code for Namibia (NamCode). So far no documentation that regulates government ministries audit committees, but only the PAC recommendations (Ihuhua, 2012).

The quality of financial reporting encourages openness and produces annual reports that are sound through adequate reporting. The financial reports should be easy to understand, compare, verify and should be timely. Economic disclosure remains the foremost avenue of interconnecting economic facts to those outside the firm assesses the economic wellbeing of a company in a bid to oversight management actions and contributes in making economic decisions (Moses, 2016).

To forestall financial statement fraud crisis, organizations take a wide range of actions which include setting up committees whose roles include watching closely the contents of the financial report from compilation to publication and beyond. One of such committees is an audit committee. The audit committee consists of a selection of members of an organization saddled with the duty of oversight of the companies' accounting and financial reporting as a good corporate governance tool which enhances the integrity of financial reporting (Eyenubo et al., 2017).

Harrison and Ochieng (2018) note that lack of clear policy guiding the tenure of audit committee members, the tenure of audit committee members, technical capacity, their independence and lack of clarity among users on the perception of audit reports are some of the key challenges affecting the audit function. The effectiveness of the audit committees within the public sector has been under scrutiny owing to the rampant fraud within the state agencies and lack of stringent adherence to the corporate governance practices. This has negatively impacted the quality of internal audit reports within the public domain (ICPAK, 2017). All these have served to underscore the importance of having a vigilant auditing committee.

Audit Committee Size and Internal Audit Effectiveness

Several empirical researches in accounting literature argued as to whether or not small or large board is effectively enhancing the quality of management responsibilities. This is because considerable audit committee members may produce knowledge and experience useful in embarking upon the provision of enhanced economic disclosure quality (Hassan, 2016). Effective audit committee size is important if efficient corporate financial reporting is to be obtained. Board size plays an important role in corporate governance of listed companies in the world in general (Salihi & Jibrin, 2015).

Streamlined boards can operate more effectively in maintaining management and can be extended to audit committee size. This indicates that smaller audit committee is more efficient in monitoring the financial reporting process, thereby reducing earnings management (Nelson & Jamil, 2014). Similarly, a huge number of audit committee size are important as they have the capacity to retain financial reporting process. Generally, as the size of the audit committee enlarges, businesses can add directors from the outside on audit committee beyond the mandated minimum requirements, which enhances audit effectiveness. As such it can be said that audit committee size constraint earnings management (Kuang & Sharma, 2013).

Audit committees serve as a bridge in the communication network between internal and external auditors and the board of directors. Lipton and Lorsch (2011) remarked that the ability “of the audit committee” oversight function rises when the figure of its memberships increases. The ability of the audit committee oversight function rises when the figure of its memberships increases. This enables it to effectively check the powers of the executive directors, with particular reference to the accounting and financial reporting functions. It further strengthens the reporting functions as it enhances the independence of auditors. (Onyabe et. al., 2018).

The committee's size should be appropriately stated. Audit committee is made up of an equal number of directors and shareholders. Where a large audit committee member exist, possible challenges emanating from financial reporting task likely has the likelihood of being exposed and settled. These inputs suggest that size constitutes a significant factor for the effective performance of the group. An audit committee size that is large spends a considerable period and means to check the financial reporting process and internal control mechanism. A bigger size of the audit committee can alleviate material differences throughout the tested equity submissions (Lipton & Lorsch, 2011).

The exact sum of members of audit committee is particularly important as it affects the commitment of memberships to monitor management and detect deceitful behaviours. Their activities include the review of nominated auditors, overall monitoring of the audit assignment, results of the audit, internal financial controls and financial information for publication. They strengthen the reporting functions as they enhance auditor independence by allowing them to report to a body that is independent of the executive directors. The size of the audit committee is an important factor in enhancing financial reporting quality as larger

audit committees are likely to have the advantage of relying on a wider knowledge base and varied expertise and thereby undertake their role more effectively (Mohammed–Nor et.al., 2010).
For instance, in Kenya a study done in government ministries on the relationship between effectiveness of audit committee and financial management studies have shown that committee audit with more than 3 members is more effective on financial management in the ministerial in comparison with those with few members (Ruto & Essajee, 2018). On contrary, a study carried out in a Nigerian back on whether there is an impact of size of committee audit on quality financial reporting; found that size of the committee audit had no significant influence on quality financial reporting in Nigerian banks. However, the insignificance of this variable confirms that audit committee size is not a major determining factor of qualitative reporting. Therefore, the study came into a conclusion that with respect to committee size on discretionary accruals that banks with large audit committee size are likely to considerably lessen earnings management (Moses, 2016)

Methodology and Materials

Research design is defined as strategy put in place to combine different components of a research to meet the research objective (Mugenda & Mugenda, 2012). It is the organization and reorganization of factors to create an environment best for data collection as well as data analysis in a way that achieves the sole objectives of the research considering budget restrictions (Kothari, 2004). This study sought to obtain descriptive and self-reported information from management and audit staff of county executive and county assembly in the county governments of Nyandarua and Kericho in Kenya. The design allowed the researcher to expose the respondents to a set of questions to allow comparison.

The target population for this study therefore, comprised of internal audit staff, accountants and revenue officers of the county executive and county assembly in both the county governments of Nyandarua and Kericho who number 35 and 32 staff members respectively. Given the comparatively small size of the population, the study adopted a census where all the staff members in both the counties were taken as respondents in the research. Structured questionnaires were used where they were distributed to all departments in both the county governments. The researcher proceeded to collect data from the selected respondents after receiving permission from the relevant authorities. First the researcher obtained a letter from the university to allow him to conduct the study. Permission from the National Commission for Science, Technology and Innovation (NACOSTI) was also obtained to allow the research to be conducted. The researcher familiarized himself with the study area before actual data collection for familiarization and acquaintance. During this visit, the researcher informed the administrators why he wants to carry out the study and as such book appointments for data collection.

The researcher used the computer software Statistical Package for Social Scientists (SPSS) version 24.0 computer software to analyze the information that was gathered from the questionnaires. Descriptive and inferential statistics were used to analyze the data. Descriptive statistics (percentages, frequencies, standard deviation and means) were presented in tables which were used to organize and summarize information. To establish the correlation between variables, Pearson product moment correlation coefficient was used. On the other hand, the beta (β) coefficients for each independent variable were generated from regression analysis to examine the individual contribution of each variable to variation in the dependent variable.

Findings

Size of Audit Committee

Respondents gave their views regarding size of the audit committee in both Nyandarua and Kericho counties. The analysis examined the means and standard deviation values of the respondent views in both the counties. The results from Nyandarua County were as presented in Table 4.9.

Table 1

Nyandarua county audit committee size

	N	Min	Max	Mean	Std. Dev
Our audit committee has the right number of committee members	29	1	5	3.24	1.354
Audit committee has a quorum when meeting	29	2	5	3.66	.974
We have a considerable audit committee members that effectively enhance the quality of management responsibilities	29	1	5	3.34	1.396
Our county has a good number of auditors who facilitate the exchange of information in our county	29	1	4	2.52	1.056
We have a small team of audit members who reduce the incidence of restatement of the minimum size requirement	29	2	5	3.62	.942
We have the required audit members who assist our government to identify potential errors in financial reporting	29	1	4	2.79	1.013
Valid N (listwise)	29				

The results indicated that respondents agreed that the audit committee has a quorum when meeting in Nyandarua County with a mean of 3.66 and a standard deviation of 0.974. Further, they agreed that they have a small team of audit members who reduce the incidence of restatement of the minimum size requirement with a mean of 3.62 and a standard deviation of 0.942. However, respondents were indifferent on whether their audit committee has the right number of committee members and whether the committee members effectively enhance the quality of management responsibilities. The respondents demonstrated great diversity in their views with most of the responses having standard deviation values greater than one apart from two items that the respondents had agreed with.

In Kericho County, the analysis of the means and standard deviation values of the respondent's views were as presented in Table 4.10.

Table 2
Kericho County Audit Committee Size

	N	Min	Max	Mean	Std. Dev
Our audit committee has the right number of committee members	25	4	5	4.40	.500
Audit committee has a quorum when meeting	25	4	5	4.28	.458
We have a considerable audit committee members that effectively enhance the quality of management responsibilities	25	3	5	4.12	.726
Our county has a good number of auditors who facilitate the exchange of information in our county	25	2	5	4.00	.866
We have a small team of audit members who reduce the incidence of restatement of the minimum size requirement	25	1	5	3.80	1.190
We have the requires audit members who assist our government to identify potential errors in financial reporting	25	2	5	3.88	.881
Valid N (Listwise)	25				

In comparison with Nyandarua County, the respondents agreed with all the views in regard to the audit committee size in Kericho County. Respondents agreed that the audit committee in Kericho County has the right number of committee members and that the audit committee has a quorum when having their meetings with a mean of 4.4 and 4.3 respectively. They also agreed that they have considerable audit committee members in Kericho County who effectively enhance the quality of management responsibilities. Comparatively, unlike in Nyandarua County, respondents demonstrated cohesion in their responses returning standard deviation values less than one. As such respondents appeared to be in agreement in matters regarding the size of the audit committee in Kericho County.

Conclusions

From Nyandarua County the researcher concluded that size of the audit committee significantly determined internal audit effectiveness. Therefore, size of the audit committee had a direct relationship with internal audit effectiveness, Hence size of the audit committee have an important role in determining internal audit effectiveness.

In addition results indicated that in Kericho county audit committee size has a significant relationship with internal audit effectiveness. Thus it was observed that audit committee size has a role in determining internal audit effectiveness County. Therefore, the researcher concluded that size of the audit committee has a significant influence on internal audit effectiveness.

Recommendations of the Study

Deriving from the study's findings, the study came up with various recommendations geared towards improving internal audit effectiveness in Nyandarua and Kericho counties. First the study recommended that the county governments should ensure that the composition of audit members should clearly be spelt out to enable their functions effectively. They should have a greater number of members who have knowledge of accounting and finance. County governments should ensure code of corporate governance in audit committee composition because it will improve the financial reporting quality in the counties. The study also recommended that counties should ensure that their audit members are independent as this is likely to enhance financial reporting quality. Therefore the county governments should ensure they make effective independence of internal audit to perform their professional obligations and duties.

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