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EFFECT OF AUDIT COMMITTEE SIZE ON FINANCIAL REPORTING QUALITY OF FIRMS LISTED IN NAIROBI SECURITIES EXCHANGE

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Abstract: *Financial reporting has in the recent past gained prominence in both the international academic and business debate more especially, on why some companies report better than others do. The absence of good audit committee characteristic has been indicated to be a major cause of failure of many well performing companies.*

Methodology: *The study adopted a census approach and thus all the 62 listed firms was used as unit of analysis. Secondary data was obtained from the existing companies' annual reports for the period 2014-2018. The study adopted a descriptive research design that generally describes the characteristics of a particular situation, event or case.*

Findings: *The study concluded that there was a positive effect of audit committee size on financial reporting quality at the Nairobi Securities Exchange (r= 0.003, p=0.001). There was a positive effect of audit gender ratio on financial reporting quality at the Nairobi Securities Exchange (r= 0.094, p=0.001). There was a no effect of audit committee frequency meetings on financial reporting quality at the Nairobi Securities Exchange (r=-0.001, p=0.538). Lastly, there was a positive effect of audit committee independence on financial reporting quality at the Nairobi Securities Exchange (r= 0.108, p=0.001).*

Recommendations: *The study recommended that audit committees should review their composition periodically to confirm that members have the knowledge and experience they need to be effective. In addition to industry knowledge, members should have a strong grasp of internal control over financial reporting and financial reporting and accounting issues such as revenue recognition, pensions and other postemployment benefits, financial instruments and critical accounting policies.*

Keywords: *Audit Committee, Financial Reporting, Nairobi Securities Exchange*

1) Audit Committee Size

The size of the audit committee could influence on the financial reporting quality of a firm (Pittman, Rui & Wu, 2017). An excessive number of committee members might influence negatively on decision making, and the costs derived from larger audit committee could overweigh the benefits. According to Samaha, Khlif and Hussainey (2015), when groups increase in size coordination problems make them less effective. Furthermore, larger audit committees are expected to monitor top managers less effectively.

A critical proportion of audit committees' observing force and viability is the number of gatherings held by the audit committee. The adequacy of audit committee gatherings varies. Johl, Kaur and Cooper (2015) express that the number of gatherings held by the audit committee estimate the force of an audit committee's exercises, and the quality or viability of its checking. A higher number of audit committee gatherings can result to higher quality administrative checking / monitoring and hence impact on better corporate financial execution (Krishnamoorthy and Maletta, 2016). Ordinary gatherings permit committee individuals more opportunity to present, set system, and to evaluate administrative execution. This can help committee individuals to stay educated and proficient about vital improvements inside the firm, and in this way place them in a superior position to opportune location developing basic issues. Further, visit gatherings intermixed with casual sideline associations can make and fortify durable securities among committee individuals and in this manner sway emphatically on corporate execution and financial reporting (Alzeban and Sawan, 2015).

Nonetheless, Hussain (2018) contends that regularly the constrained time committee individuals spend together isn't utilized for the significant exchange of thoughts among themselves. Rather, routine undertakings, for example, introduction of the executives reports and different conventions retain a great part of the gatherings, and this lessens the measure of time that outside committee individuals would need to successfully screen the board (Juhmani, 2017). This could affect adversely on corporate execution. Also, audit committee gatherings are exorbitant as administrative time, travel costs, refreshments and committee individuals' gathering charges that can adversely impact corporate execution.

Assorted variety of directors and audit committee individuals has been a standout amongst the most vital audit committee trademark issues; in this manner, corporate financial reporting. Gender assorted variety advances diverse mindsets (Al-Matari, Al-Swidi, Fadzil and Al-Matari, 2016). Organizations including more ladies on audit committee and senior administration levels reflect ensuring the interests' of different partners; in this manner, a positive relationship is normal between ladies' essence on audit committee and senior administration and corporate financial reporting (Arslan, Zaman, Malik and Mehmood, 2014). Females convey distinctive characteristics to audit committees where they are seen to have a progressively participative, just and common initiative style (Liao, 2015). This may prompt improved audit committee viability because of the improved quality of audit committee thoughts and better control of the company’s financial reports.

A key constituent of market-arranged audit committee trademark is the closeness of the outside, autonomous individuals from the audit committee to speak to investor premiums (Wachudi and Mboya, 2015). Free audit committee individuals may give advices about key choices, and improve checking of choices and the chiefs’ exercises, along these lines decreasing advantage. Autonomous committee individuals might be chosen by square holders to speak to their interests and might most likely obtain data legitimately, instead of through open financial reporting. Outside committee individuals may likewise go about as a substitute for checking through open financial reporting (Chen, 2015). Be that as it may, an inadequate learning of business is indicated out as an awkward be viewed as when the quantity of autonomous chief is unnecessary, since it would decrease audit committee viability (Barako, 2017).

2) Financial Reporting Quality

A firm financial reporting entails releasing all relevant information on a company that may influence an investment decision (Madawaki & Amran, 2017). To make contributing as reasonable as workable for everybody, recorded firms must uncover both great and terrible data. Financial reporting things include things identified with an organization's financial condition, working outcomes, and the executives remuneration (Musyoka, 2016). Explicit financial reporting prerequisites are required in light of the fact that particular financial reporting set speculators' and friends partners off guard. This likewise keeps insiders from utilizing non-open data for their own addition to the detriment of the general contributing open (Müller, Riedl and

Sellhorn, 2015). Unmistakably sketched out financial reporting necessities guarantee that a firm enough spreads data, so all speculators are on a notwithstanding playing field. Recorded organizations data is conveyed to speculators whether straightforwardly, through financial reports and official statements, or in a roundabout way, by means of data mediators, for example, financial experts or financial middle people, for example, banks (Ongore, Peter, Ogutu and Bosire, 2015).

Financial reporting is a powerful device for improving speculator security. Numerous financial specialists base their venture choices on firms by the data accessible in a specific firm. Along these lines, they will need to be as certain that the firm is financially stable and will keep on being so within a reasonable time-frame. Speculators investigate the distributed yearly report and records of the business and to other data discharges that the organization may make. It is their desire that the yearly report speak to a genuine image of the organization's present position. In this manner, financial and corporate reporting assumes a critical job in some random economy (Glaeser, Michels & Verrecchia, 2018).

Raithatha and Bapat (2014) used the disclosure index to measure financial reporting quality listed firms in India. Based on disclosures requirements of International Accounting Standards a checklist consisting of 171 items of financial reporting and disclosures can be used to measure financial reporting quality. The disclosures requirements are broken down into 171 items to ensure objectivity is achieved.

3) Statement of the Problem

Research has demonstrated that there is a connection between the quality exposure of enterprises and the administration practices of their audit committees (Tricker & Tricker, 2015); Kiel and Nicholson, 2016). Gompers, Ishii and Metrick (2013) in the United States by found a solid connection between great audit committees' qualities and revelation. Owino (2013) set up negative connection between size of the audit committee and the cost of involved in the execution; Sozi (2013) noted that the audit committee revelation is adversely corresponded to adequacy of the audit committee and viability of audit committee was discovered influenced by audit committee creation and quality, size of audit committees audit committee assorted variety, data asymmetries and audit committee culture. Katuse, Kiambati, Ngugi and Waititu (2013) found out that the size of the audit committee is negatively related with the execution of the firm.

Even though different research has been carried out it is not clear how the attributes of the audit committee affect the quality of financial statements. This study will, therefore, seek to find out the effect of audit committee size on financial reporting quality of firms listed in the Nairobi Security Exchange.

4) Objective of the study

The study was guided by the specific objective; to establish the effect of audit committee size on financial reporting quality of firms listed in Nairobi Securities Exchange and by the following research hypothesis;

i. Audit committee size has no significant effect on financial reporting quality of firms listed in Nairobi Securities Exchange

5) Conceptual Framework

Figure 1 below shows the correlation between audit committee size and its on financial reporting quality of companies listed in Nairobi Securities Exchange.

Independent Variable

Audit Committee Size
- No. of audit committee members
- Quorum of members

Dependent Variable

Financial Reporting Quality
Ratio= Total No. of financial reporting Made / Total financial reporting

Figure 1: Conceptual Framework

6) Discussion and Interpretation of Findings

This part deals with analysis and presentation of data on the relationship audit committee characteristics on financial reporting quality of companies listed in Nairobi Securities Exchange. It starts by covering the descriptive statistics followed by specification and estimation of the model, and finally, a discussion and interpretation of the research findings.

7) Descriptive Statistics

This section provides a summary of the data obtained for each of the variables in this study. The descriptive statistics employed were; mean, median, maximum and minimum values, standard deviation. These statistics are discussed in Table 1.

Table 1: Descriptive Statistics

	Audit Commit Size	**No. Males**	**No. Females**	**Frequency of Meetings**	**Executive Members**	**Non-Executive Members**
N	310	310	310	310	310	310
Min	3.000	2.000	0.000	4.000	1.000	1.000
Max	24.000	15.000	9.000	21.000	15.000	12.000
Mean	9.00	6.000	2.000	5.000	3.000	5.000
Std. Devi	0.346	4.000	1.000	3.495	1.695	2.450
Skewness	1.054	0.662	0.988	3.030	3.328	0.277
Kurtosis	-0.960	0.124	2.124	-0.867	2.678	-0.284

Table 1 shows that the minimum and maximum values of the number of audit committee members was 3 and 24 respectively. The mean value for audit committee members was 8.920. The standard deviation of 3.346 indicated that there were variation in audit committee member's rate overtime. In addition, the results showed that the minimum and maximum of males in the audit committee was 2 and 15. The mean for males was 7 with a standard deviation of 2.611. On the other hand, the minimum and maximum of females in the audit committee was 0 and 9. The mean for females was 2 with a standard deviation of 1. This indicated that there were more males that females in the audit committee at Nairobi Securities Exchange listed firms from the period 2014-2018. Further results showed that the minimum and maximum audit committee meetings was 4 and 21 respectively. The mean value for board meetings was 5. The standard deviation of 3 indicated that there were variation in board meetings rate overtime.

The results further showed that the minimum and maximum of executive members in the audit committee was 1 and 15. The mean for executive members was 3 with a standard deviation of 1.695. On the other hand, the minimum and maximum of non-executive audit committee in the audit committee was 1 and 12. The mean for non-executive members was 5 with a standard deviation of 2.45. This indicated there were more executive audit committee than non-executive audit committee were for the period 2014-2018.

The measures of kurtosis and skewness are used to determine if indicators met normality assumptions (Kline, 2005). According to Bai and Ng (2005), if skewness is less than -1 or greater than 1, the distribution is highly skewed, if skewness is between -1 and 1 or between 0.5 and 1, the distribution is moderately skewed, if skewness is between 5 and 5, the distribution is approximately symmetric. The skewness for audit commit size was 1.054, number of males at 0.662, number of females at 0.988, and frequency of meetings at 3.030, executive members at 3.328 and non-executive members at 0.277. Since the values were between -5 and 5, we thus conclude that the distribution is approximately symmetric. The skewness for audit commit size was -0.960, number of males at 0.124, number of females at 2.124, and frequency of meetings at -0.867, executive members at 20.678 and non-executive members at -0.284. Thus, we can conclude that the values were platykurtic since they are less than 3 and thus had a broad tail distribution and no outliers.

Anderson (2014) argues that if the size of a team is large, individual members may be more vulnerable to the pressures and more subject to follow the others' opinion without giving another argument. Srinidhi and Ng (2014) find that the existence of women in the audit committee decreases the opportunistic behaviors and financial misstatements. According to Krishnamoorthy and Maletta (2016), a higher frequency of audit committee meetings can result in a higher quality of managerial monitoring, and thereby impacts positively on corporate financial performance. Azofra and Lopez (2015) suggest that audit boards with a significant proportion of independent audit members is more effective in monitoring management and, therefore, they can limit the exercise of managerial discretion.

8) Trend Analysis

This section presents the analysis of the trends of the variables. The study conducted a trend analysis to establish the movement of the variables overtime. The trend analysis are as shown in Figure 2 to 4.

Figure 2: Trend Analysis for Financial Reporting

Figure 2 shows that the reporting quality for the firms had an increasing trend from the year 2014 to the year 2018. However, in 2017 there was a slight stagnation which may have been caused by political influence during the 2017 election period. The financial reporting was analyzed using the disclosure index for the listed companies at the Nairobi Securities Exchange. The results show that disclosure index had increased over the 5 years in the listed companies. The financial reporting items comprise items related to a company's financial condition, operating results, and management compensation. The disclosures are made via financial reports and press releases, or indirectly, via information intermediaries such as financial analysts or financial intermediaries.

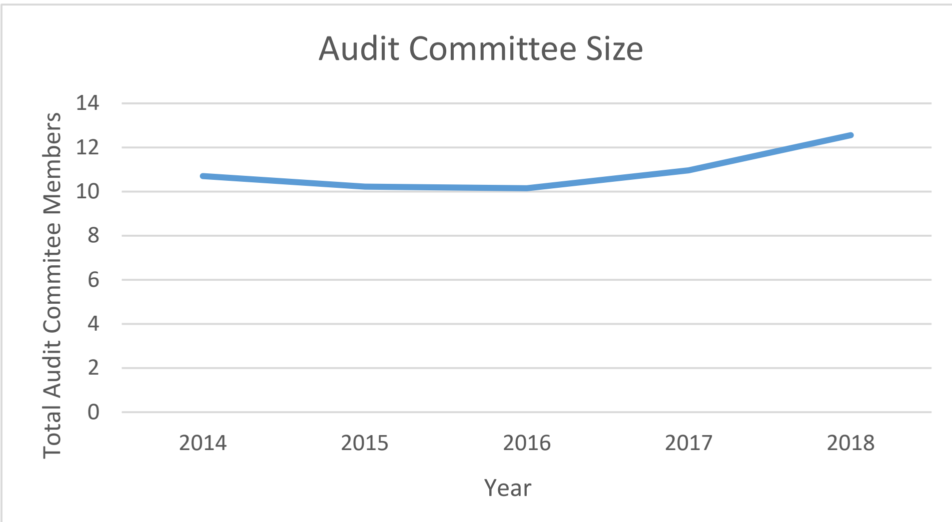

Figure 3: Trend Analysis for Audit Committee Size

Figure 3 shows that the total numbers of the audit committee members as relatively even from the year 2014 to the year 2018. This indicates that the total audit members has not been varying much during the period. This could be a possible effect due to the expenses of maintain large audit committees that are entitled to remuneration. Anderson (2014) argues that if the size of a team is large, individual members may be more vulnerable to the pressures and more subject to follow the others' opinion without giving another argument. Haron, Jantan and Pheng (2015) find that a small team will facilitate the exchange of information in the firm and a better discussion between members, to assist management to identify potential errors in financial reporting and reduce the incidence of restatement of the minimum size requirements.

9) Diagnostics Tests

Panel diagnostic tests were done to check for any violations of the assumptions underlying the panel regression model and to select the appropriate estimation model based on the results of the diagnostic tests. The main objective of these tests was to avoid spurious regression results. The diagnostics tests include ADF Root Test, Test for Fixed or Random Effects, Normality Tests Multicollinearity, Autocorrelation and Heteroscedasticity.

Normality Tests

Test for normality determines if the data is well modeled and normally distributed (linear). It is used to measure how far data deviates from the Gaussian by looking at the graph and determining if the distribution deviated grossly from a bell- shaped normal distribution. It is a determination of the likelihood of a random variable being normally distributed. It is an assessment of the normality of data in statistical tests. Avioli (2012) showed that descriptive, normality, and verification tests could be assessed with the normal distribution. To test the normality of the variables, Shapiro–Wilk test was used as it has the highest power among all tests for normality. The hypothesis was tested at a critical value at 0.05, where the rule is that reject H_0 if the probability (P) value is less than 0.05 or else do not reject. The dependent variable should be normally distributed because the study was analyzed using a multiple regression model where the condition of normality must be satisfied (Quataroli & Julia, 2012). The hypothesis was that;

H1: The data is normal.

The results for normality are as shown in Table 2 below.

Table 2: Test for Normality

	Shapiro-Wilk Statistic	df	Sig.
Audit Committee Size	0.982	310	0.329
Financial Reporting Quality	0.941	310	0.074

Table 2 indicates that using the Shapiro-Wilk test of normality, the data is normal since the p-values are above 0.05 for all the variables and thus we do not reject the alternative hypothesis (H_1). The study concluded that audit committee size and financial reporting quality values are normal in distribution and hence subsequent analysis can be carried out.

10) Inferential Statistics

Inferential analysis was conducted to generate correlation results, model of fitness, and analysis of the variance and regression coefficients.

Correlation Analysis

Correlation analysis was conducted to establish the relationship between the independent and dependent variables. The correlation matrix is presented in Table 3.

Table 3: Correlation Matrix

	Financial Reporting Quality	Audit Committee Size
Financial Reporting Quality	1.000	
Audit Committee Size	0.7068*	1.000
	0.000	

Correlation results in Table 3 revealed that audit committee size and financial reporting quality are positively and significantly related (r=0.7068, p=0.000). This implies that an increase in audit committee size led to increase in financial reporting quality at the Nairobi Securities Exchange.

11) Regression Analysis

The study sought to carry out regression analysis to establish the statistical significance relationship between the independents variables notably audit committee size on the dependent variable that was financial reporting quality at the Nairobi Securities Exchange. According to Rencher and Schaalje (2009) regression analysis is a statistical process of estimating the relationship among variables. It includes many techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent and one or more independent variables. More specifically, regression analysis helps one to understand how the typical value of the dependent variable changes when any one of the independent variable is varied, while the other independent variables are held fixed (Mugenda & Mugenda, 2003).

The results presented in Table 4 present the fitness of model used of the regression model in explaining the study phenomena.

Table 4: Regression of Coefficients

Financial Reporting	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
Audit Committee Size	0.003	0.001	3.300	0.001	0.001	0.005
R-sq: Overall = 0.6153						
F statistics =96.13						
Prob > chi2 = 0.0000						

Multiple regressions were done since the study had an independent variable as shown in Table 4. The Rsquared was used to check how well the model fitted the data. The study was supported by coefficient of determination R square of 0.6153. This means that audit committee size explain 0.6153% of the variations in the dependent variable that is financial reporting quality at the Nairobi Securities Exchange.

The results revealed that there was a positive effect between audit committee size and financial reporting quality at the Nairobi Securities Exchange (r= 0.003, p=0.001). This was supported by a calculated t-statistic of 3.300 that is larger than the critical t-statistic of 1.96. The regression model was;

$Y = 0.655 + 0.003X_1$

Where: Y = Financial Reporting Quality

X_1 = Audit Committee Size

The findings agree with Abeysekera (2017) conducted a study on the influence of audit committee size on financial Reporting by Kenyan listed firms and found that firms disclosing more tactical internal capital and more strategic human capital had larger audit committee. The findings provided insights into how a larger audit committee size can help boards to overcome skill deficiencies in making more discretionary disclosure related to future earnings. The findings are consistent with Okiro (2016) who examined the relationship between audit committee size and audit committee composition on firm performance using quoted companies at the Nairobi stock exchange. He found that there was no significant relationship between audit committee size and firm disclosure.

12) Hypotheses Testing

Hypotheses were tested using multiple linear regression analysis.

The hypothesis to be tested was:

H_{01}: Audit committee size has no significant effect on financial reporting quality of firms listed in Nairobi Securities Exchange.

The hypothesis was tested by using multiple linear regression and determined using p-value. The acceptance/rejection criteria was that, if the p value is less than 0.05, we reject the H_{01} but if it is more than 0.05, the Ho_1 is not rejected. The results in Table 4.8 indicate that audit committee size had a positive and significant relationship on financial reporting quality (β=0.003, 0.001). The null hypothesis was therefore rejected. The study therefore adopted the alternative hypothesis that audit committee size has a significant effect on financial reporting quality of firms listed in Nairobi Securities Exchange.

The findings provided insights into how a larger audit committee size can help boards to overcome skill deficiencies in making more discretionary disclosure related to future earnings. The findings are consistent with Okiro (2016) who examined the relationship between audit committee size and audit committee composition on firm performance using quoted companies at the Nairobi stock exchange. He found that there was no significant relationship between audit committee size and firm disclosure. Baker and Gompers (2013) point out that firms with complex businesses need larger audit committee because of the difficulties involved in monitoring and advising such firms and also requirement of greater linkages to the external environment. Large audit committee are usually more powerful than small audit committee and, hence, are considered necessary for organizational effectiveness and help strengthen the link between corporations and their environments, provide direction and advice regarding strategic options for the firm and play a crucial role in creating corporate identity. Further, large audit committee, members with diverse backgrounds bring knowledge and intellect to the boardroom.

13) Discussion of Findings

Correlation results revealed that audit committee size and financial reporting quality are positively and significantly related (r=0.7068, p=0.000). Regression analysis revealed that there was a positive and significant relationship between audit committee size and financial reporting quality at the Nairobi Securities Exchange (r= 0.003, p=0.001). This was supported by a calculated t-statistic of 3.300 that is larger than the critical t-statistic of 1.96. This means that a unitary improvement in audit committee size leads to an improvement in financial reporting quality by 0.003 units holding other factors constant.

The findings agree with Abeysekera (2017) conducted a study on the influence of audit committee size on financial Reporting by Kenyan listed firms and found that firms disclosing more tactical internal capital and more strategic human capital had larger audit committee. The findings provided insights into how a larger audit committee size can help boards to overcome skill deficiencies in making more discretionary disclosure related to future earnings. The findings are consistent with Okiro (2016) who examined the relationship between audit committee size and audit committee composition on firm performance using quoted companies at the Nairobi stock exchange. He found that there was no significant relationship between audit committee size and firm disclosure.

Baker and Gompers (2013) point out that firms with complex businesses need larger audit committee because of the difficulties involved in monitoring and advising such firms and also requirement of greater linkages to the external environment. Large audit committee are usually more powerful than small audit committee and, hence, are considered necessary for organizational effectiveness and help strengthen the link between corporations and their environments, provide direction and advice regarding strategic options for the firm and play a crucial role in creating corporate identity.

The study findings are in tandem with Katuse, Kiambati, Ngugi and Waititu (2013) who conducted a study on the role of audit committee size on financial performance of commercial banks in Kenya. The study predominately foresees that audit committee size is negatively associated with firm performance. Increasing number of directors on the audit committee above an ideal limit may have more deteriorating effect on firm value. Below a certain audit committee size, the relationship between firm value and audit committee size is less negative and above that, it increases. Audit committee of larger companies have less negative association with firm performance than those of smaller firms. The argument is that audit committee of larger companies may well be equipped with resources, skill base and knowledge expertise to take strategic decisions in period of financial distress. The audit committee of smaller companies may lag behind to actively utilize resources and drive performance.

The findings by According to Gandia (2018) showed that increasing the number of audit committee members improves the capability of the board in monitoring and controlling management actions. This enhances the transparency and the disclosure of more information by management. As larger audit committee have varied experiences and dispersed opinions, it increases their monitoring capacities, and enhances the firm's disclosure policies report a positive relationship between audit committee size and extent of voluntary disclosure, indicating an audit committee capability to influence managers to disclose more voluntary information.

14) Summary of Findings

This section provides a summary of the findings from the analysis. This was done according to the objectives of the study where analysis was done from the data collected. The primary objective of the study that was to determine the effect of audit committee characteristics on financial reporting quality in firms listed in the Nairobi Securities Exchange.

Audit committee size was found to be satisfactory in explaining financial reporting quality. Further, results showed that audit committee size is a good predictor of financial reporting quality. Correlation results revealed that audit committee size and financial reporting quality are positively and significantly related. Regression analysis revealed that there was a positive and significant relationship between audit committee size and financial reporting quality at the Nairobi Securities Exchange. The results showed that a unitary improvement in audit committee size leads to an improvement in financial reporting quality by 0.003 units holding other factors constant. The null hypothesis was therefore rejected. The study therefore adopted the alternative hypothesis that audit committee size has a significant effect on financial reporting quality of firms listed in Nairobi Securities Exchange.

Based on the findings the study concluded audit committee size had a significant effect on financial reporting quality of firms listed in Nairobi Securities Exchange. The results of the study have shown that large size audit committees can protect and control the process of accounting and finance since there is increased expert advice with increased size of the audit committee. It is therefore utmost necessary for firms to re-elect audit committee members that have served for more than 9 years to the board because of their vast experience. Having experienced audit committee members should be a key priority for firms. There is need for firms to have an audit committee that is not too small such that there is lack of expert advice and too large such that it has free riders that are prone to follow other members opinion. The size of the audit committee should also be in a way that the process of accounting and finance are protected and firm performance is increased

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