Audit Committee Attributes, Firm Characteristic and Financial Reporting Quality of the State-owned Commercial Enterprises in Kenya

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Abstract

Purpose of Study: *The purpose of the study was to establish the moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya.*

Methodology: *The study applied secondary data extracted from annual reports and audited financial statements of state-owned commercial enterprises in Kenya for the period between 2008 and 2018 using data capture forms. Several statistics and diagnostic tests were conducted to test the hypotheses including panel data regression models. Baron and Kenny (1986) approach was adopted to test for moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality.*

Findings: *The results reveal that firm characteristics had no significant moderating effect on relationship between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. However, the results also indicated that firm liquidity had statistically and significantly influenced the relationship between audit committee independence and financial reporting quality.*

Implications: *The study focused on the state-owned commercial enterprises in Kenya and therefore, the results might not be representative for the all state-owned entities. Additional studies may be conducted incorporating all state-owned entities for a true reflection on the results. Further, the study also narrowed its data between 2008 and 2018 period. Future studies could be done for all state-owned entities including prior period before 2008.*

Keywords: *Audit Committee Attributes, Firm Characteristics, Financial Reporting, State-owned Commercial Enterprises*
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1.0 Introduction

Mohiuddin and Karbhari (2010) suggests that the demand for corporate governance mechanisms has increased due to the occurrence of numerous eminence accounting impropriety (Enron; WorldCom) placing the roles of audit committee making over-sighting fraudulent financial reporting questionable. Financial reporting consumers depend on quality financial information disclosures in financial statements and annual reports. Furthermore, Bedard and Gendron (2010) notes independent audit committee meeting frequently buttress standard of financial information disclosure while nourishing financial reporting quality. This is perceived to upgrade quality of financial information through oversight of financial reporting process building investor confidence (Bedard and Gendron, 2010). Chen et al, (2008) and Turley and Zaman (2007) argue that audit committee contributes to oversight while cushioning shareholders' interests in companies and does not reflect any association between audit committee attributes and financial reporting quality (Wallace and Nasser, 1995) of state-owned commercial enterprises as noted by Wallace and Nasser (1995).

Researchers have employed varying theories in audit committee research depicting from distinct context inclusive of economics, psychology, sociology and legal. The legal context argue that law and regulations dictate roles and responsibilities of audit committee and agency theory propose that keeping an eye on management by audit committee reinforce financial information disclosure and reporting process quality (Bedard and Gendron, 2010). Bedard and Chi (1993) observe that expertise paradigm as one of the psychological viewpoint coupled with the institutional theory affirms the interdependence between audit committee qualification and financial reporting quality. Further, Turley and Zaman (2007) assert that audit committee may impact as backed by power theory on and be overwhelmed by application of rules by members and stakeholders drawing influence from divergent authority.

1.1 Audit Committee Attributes

Increased developments in regulatory and stakeholder demands have led to recognition of audit committee attributes as a key component of corporate governance structure. While DeZoort et al., (2002) observe that audit committee attribute is at trait impacting the operations and effectiveness of audit committee which is considered as a team with qualified members with ability expertise and capability to insulate shareholder's interest by assuring steady financial reporting strong internal controls. Furthermore, Sarbanes Oxley Act (SOX) (2002, 205) observe that audit committee is a team created by and among the directors of a company with the role of providing oversight over financial reporting

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processes and conduct of financial statement's audits.

SOX (2002) assert that independent audit committee reflects strongly in strong internal controls and boosts effective monitoring of financial reporting process in support of its oversight role over financial reporting. Audit committee is assumed in aiding the board in overseeing the integrity of financial statements, company's compliance requirements, and recruitment of independent auditor as well as the qualification and independence, and performance of the internal audit function through strong institutional structures as supported by institutional theory (Woodlock, 2006). Public Finance Management Act 2012 and regulation 2015 establishes audit committees guidelines in the state-owned commercial enterprises in Kenya laying down its structure, role and responsibilities.

Numerous scholars have employed diverse research methodologies to measure impact of audit committee attributes on financial reporting quality. Mohiuddin and Karbhari (2010) applied audit committee attributes of independence, qualification/financial knowledge of members, size and frequency of meetings in determining audit committee effectiveness. Woodlock (2006) further suggest that effective oversight by audit committee commences alongside with competence and independence of members. DeZoort et al. (2002) asserts that an independent audit committee safeguards stakeholders' concern by assuring dependable financial reporting, efficient and potent internal control. The study adopts audit committee independence, member qualification, size and number of meetings held annually as applied by Mohiuddin and Karbhari (2010) to evaluate the impact on the identified variables.

1.2 Firm Characteristics
There are innumerable firm characteristics signaling dissimilar association crosswise in organization. Eng and Mark (2003) argue that firm characteristics are characterizing features or idiosyncrasy that could impact financial reporting. Firm characteristics are viewed as variables driving and stirring financial reporting quality and corporate information disclosures (Sehu and Bello, 2013). Sehu and Bello (2013) further observe that many firm specific characteristic differ consistently across firms in distinctive sectors affecting financial reporting environment. Importantly Aljifri, Alzarouni and Tahir (2014) in their study reveal that firm size, leverage and industry type characteristics significantly associate with immense corporate discloser culminating into improved quality financial reporting while other studies involving profitability and liquidity remains inconclusive (Bronson, Carcello, Raghunandan, 2006).

Kinney and McDaniel (1989) conclude that small sized firms and less profitable with lower growth rate involve in earnings management lower the quality of information disclosure as supported by Defond and Jiambalvo (1991) while having high leverage than

their industry average (Callen et al., 2002; Chan et al., 2002). Wallace and Naser (1995) assert that corporate disclosures in financial statements differ positively with firm size while profitability is negatively associated indicating that firms with higher profitability tend to provide insufficient information in financial statements.

Glosten and Milgrom (1985) notes that firms with better quality financial information limit information asymmetry resulting to increased liquidity. Furthermore, researchers identify that firm size, leverage, board composition, institutional shareholding, profitability, liquidity and firm growth as some firm specific characteristics that affect financial reporting quality (Kinney and McDaniel, 1989). This study has utilized firm size measured by total net assets, profitability determined by net income, liquidity ratio and growth assessed by increase in gross revenue.

1.3 Financial Reporting Quality in State-owned Commercial Enterprises

Financial reporting quality is a major critical factor among financial reporting stakeholders including regulators, practitioners and other consumers of financial reporting information since it remains the dominant avenue for disseminating financial performance to stakeholders. Conversely, Pomeroy and Thomton (2008) notes that researchers, practitioners and regulators are not in concession to an impeccable picture of financial reporting quality (Pomeroy and Thomton, 2008). In addition, Martinez-Ferrero (2014) exemplifies financial reporting quality as the faithfulness of the information as reflected in the financial reporting process. Moreover, SOX (2002) require audit committee to confer the quality of financial reporting approach and not their notoriety but declines to construe what constitute the quality financial reporting. Without doubt, IASB (2008) concludes that the quality of financial reporting quality is determined by that meeting the objectives and qualitative characteristics of financial reporting.

Whereas Beasley (1996) observed that financial reporting provides information about the management's stewardship, entity's assets, liabilities, equity, income and expenses, contributions and distributions to owners, indeed IASB (2010) argue that relevance and faithful representation of financial information are primary qualitative characteristics of financial statements and financial reporting is predicated in furnishing information useful investment, credit and resource allocation decisions. Myriad of researchers (Bushman and Smith, 2001; Healey and Palepu, 2001; Lambert et al., 2007) have applied accrual and value relevance models concentrating on earnings quality evaluation and some are obsessed on definitive aspects in annual reports and mechanism operationalizing qualitative characteristics.

Vantendeloo and Vansstrealen (2005) argue that accrual models only use financial information while overlooking non-financial information from audited financial

statements and annual reports. In addition to this, it has been advanced that earning persistence, timeliness in reporting, audit fees charged, disclosure quality and adoption and compliance with the international financial reporting standards' (IFRS) requirements drive financial reporting quality (Biddle and Hillary, 2006 and Lambert et al., 2007). The studies contend that financial reporting quality continue as the preeminent origin of external information to diverse financial reporting stakeholders. State-owned commercial enterprises in Kenya reports under the International Financial Reporting Standards framework.

1.4 State-owned Commercial Enterprises

State-owned commercial enterprises are incorporated bodies independent of mainstream civil service for driving service delivery and considered as part of State handling production, ownership, sale, provision, delivery or allocation of goods and services by and for the government or its citizens, whether national, regional, local, or municipal (Barlow, Reohrich and Wright, 2010). Dooren (2006) assert that the legal facet encompassing financial and functional should be recognized in designating the public sector. Importantly, it is argued that the only approach in improving economic payoff is to uplift level of productivity while developing management quality where government require to tap soon-to-be manpower, material and financial resources and utilization of feasible resources for production and operation (Guoming, 2007).

Researchers have described State-owned commercial enterprises (SOCEs) as organizations instituted solely or by controlling majority shareholding by government and/or its institutions or a body incorporated through an Act of parliament to meet commercial objectives (OECD, 2005a, 36; Wamalwa, 2003 and PTPR, 2013). SOCEs have exhibited weak corporate governance structures and ineffectual audit committees characterized by indigent financial reporting resulting to misappropriation of public resources. This has been revealed by increment in financial restatements (Ogoro and Simiyu, 2015), Public Investment Committee (PIC), Public Accounts Committee (PAC) and Auditor General's reports (2013-14, 2014-15, 2015-16, 2016-17 and 2016-2018) affirming dereliction in financial reporting. Additionally, scandals have been experienced in various public institutions such as Mumias Sugar and Kenya Pipeline leading to questions on competence, capacity and effectiveness of audit committees in contributing to tenacious strong oversight on governance, control and quality financial reporting processes and reports.

In spite of clarity on financial reporting framework and laws legislated, weakness in governance, accountability, efficiency and effectiveness in utilization of public resources has continued to be a considerable burden to the public even so the constitution, Public Finance Management Act 2012 and published audit committee guidelines (PSASB, 2015)

for establishment of audit committees in the public sector have been established. Whereas governance structures instituted, audit committees established and statutory audit by the Office of the Auditor General no change in quality of financial reporting accomplished. This has led to diverse questioning the integrity of financial reports conferred. Prior studies have focused on public listed firms and private sector entities and therefore, making State-owned Commercial Enterprises to be selected for this study.

2.1 Literature Review

This study contributes to the existing empirical literature. Olowokure et al. (2015) in their study used multiple regression analysis to investigate the association between firm characteristics and financial reporting quality on listed deposit taking banks in Nigeria for a period between 2005 and 2014. The study finds insignificant connection between firm size, leverage and financial reporting quality. Empirical evidence shows that profitability as a measure of firm characteristics influence financial reporting value and that firms with frequent audit committee meetings reduced financial reporting improprieties (Alsaeed, 2006).

Alsaeed (2006) studied the association between firm specific characteristics and disclosure in Saudi Arabia using multiple regression analysis for 40 firms' annual reports in 2003. The study found a significant affirmative relationship amongst firm size and level of disclosure in financial reports and no evidence of the association with audit committee attributes. Furthermore, Aljifri et al. (2014) confirm that firm size, listing status and industry type have significant association with financial disclosure. Equally, level of firm profitability and size are seen to influence manipulation of accounting accruals (Klein, 2002b; Yang and Krishnan, 2005; Davidson, Stewart and Kent, 2005).

Madawaki and Amran (2013) examined the relationship between audit committee attributes with financial reporting quality and firm size in Nigerian companies. While the study used archival data and adopted Dechew and Dichev (2002)'s model and finds a positive relationship between audit committee with independent chair and accounting or financial knowledge and financial reporting quality, Jennifer (2014) assert that firm characteristics have effect on financial reporting quality but no clear link with audit committee attributes.

The literature reviewed indicate that regulators, shareholders, scholars, investors and practitioners have scrutinized financial reporting quality and imminent governance structures where existing data has linked quality of financial information and reports to impact of firm specific characteristics on the association of audit committee attributes and financial reporting quality in public listed companies (Warren and Reeve, 2004; Bedard and Gendron, 2010). Whereas Francois and Kyle (2011) and Schoar (2003) and Bamber

et al, (2010) observed that audit committee size impact financial reporting quality positively and audit committee independence shows no positive relationship with financial reporting quality, the influence of firm characteristics on the relationship between audit committee attributes and financial reporting quality has not been demonstrated as confirmed by Sehu and Bello (2013). In regard to literature reviewed, the study examined moderating effect of firm characteristics on the relationship between audit committee attributes and financial reporting quality of State-owned commercial enterprises in Kenya and tested the following hypothesis.

H_0: *Firm Characteristics has no moderating effect on the relationship between Audit Committee Attributes and Financial Reporting Quality in state-owned commercial enterprises in Kenya*

2.2 Theoretical Framework

According to Jensen and Meckling (1976) defines agency association as an agreement through which one person (principal) engages another (the agent) to accomplish some solutions on his/her behalf. Ross (1972) contends that agency problems are common in community, not purely as a muddle in the presumption of the corporation. Information asymmetry is viewed to be associated with principal's and agents' economic inducements to capitalize on different information systems to scale down the firm expenses (Jensen & Meckling, 1976; Fama & Jensen, 1983).

Mohiuddin and Karbhari (2010) observed that audit committee safeguards stakeholders' returns by its equitable and impartial opinions and discernment. Bedard & Gendron, (2010) assert that Audit committee strengthens information quality through monitoring of executive and auditors hence decreasing agency costs. The reduction of agency problems through separation of control and ownership provides the ground for the promotion of good corporate governance mechanisms, strong internal controls and audit committee enhancing accurate financial reporting.

Chen et al. (2008) considered non-US companies dealing in stock in US market and assert that functional audit committee could sort out agency difficulties of foreign firms no matter the corporate governance representation adopted by firm's place of origin. Dey (2008) claim that the extent and severity of agency complication is rarely in companies where audit committee is effectual based on conformation and expertise resulting in financial reporting quality.

Greiling (2006) argue that agency theory presume that players are driven alongside intelligent egocentric while agents utilize gaps in agreements to their benefit and concludes that agency challenge emerges besides a conflict of interest notwithstanding agent's confidential acquisition of data and agents' gravitation in utilization of their

knowledge to their benefits. Jacobides and Croson (2001) posit that key dispute is to gain fully from utilizing reasonable advantage to attain benefit of the shared agency owing to disproportionateness of facts, invisible individualities materialize prior to validation of agreement and that an agent has privileged information, capability and skills which may compromise information quality.

Lane et al. (1998) suggest that expectations of economic theory are uncorroborated in instances where executive curiosities are in dissension with those of shareholders. In addition, prior research using agency theory in examining the association of the structure of audit committee with various agency costs has generated blended outcome (Pincus et al., 1989; Bradbury, 1990) and have not resulted into systematic evaluation of actions or potency of such panels as confirmed by findings of Kalbers & Fogarty, 1993. Hence, the theory examined effects of audit committee attributes, firm characteristics and internal control framework and reducing information asymmetry while revamping the quality of information in financial reporting chain.

3.0 Research Methodology

The research is anchored on positivism research philosophy where Simpson (2009) contends that a researcher adopts a research philosophy in a specific study to mirror far-reaching inferences about his judgment and perspectives and the manner he perceives the world. Saunders et al., (2009) argue that an investigator's unequivocal perspective and assessment of the interdependence of comprehension with procedure developed influencing a choice of specific philosophy.

The study adopted descriptive research design since the sought to establish relationships amongst three variables consisting of audit committee attributes, firm characteristics and financial reporting quality using a measureable paradigm. Punch (2003) notes that to achieve research objectives and goals, appropriate methods must be applied. Robson (2002) argue that quantitative research is suitable in cases where the association among variables is measured and it is consistent with Coopers and Schindler (2006) argument. According to Creswell (2002), a germane delineation to investigate the interconnection amongst variables is conjecturing and correlational determinable exploration approach.

The population of study consisted of 122 state-owned commercial enterprises whose secondary data was gathered from annual reports and audited financial statements for a period of 11 years between 2008 and 2018. Panel data regression models were used while Baron and Kenny (1986) approach was adopted to test for moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality state-owned commercial enterprises in Kenya.

The study examined the moderating effect of firm characteristics on the relationship between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya (SOCE). The audit committee attributes comprised of independence (AC_IND), qualification (AC_QUA), size (AC_SIZ) and number of meetings held in a year (AC_MEET) whereas accrual quality (AQ), qualitative characteristics (QC) and timeliness in reporting (TR) were applied in the test as measures of financial reporting quality (FRQ).

The study applied panel regression analysis to establish the moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality using the following models to test the second hypothesis.

$$FRQ_{it}= \alpha+ \beta_1 ACA_{it} + \beta_2 FC_{it} + \beta_3 ACA*FC_{it} + u_{it}$$

Where:

FRQ_{it}:	Financial Reporting Quality indicator for i SOCE in year t
β_0	Intercepts
β_{1-3}	Coefficient of independent variables

AC_IND   Audit Committee Independence used as proxy for Audit Committee Attributes

ACA   Composite score of Audit Committee Attributes computed as a geometric mean of audit committee attributes

FC   Composite score of Firm Characteristics computed as a geometric mean of Firm Characteristics components.

u_{it} is error term

4.1 Findings

The research employed descriptive statistics comprising of mean, median, standard deviation, minimum and maximum to analyse and summarize the study variables. The data covers 122 State-owned Commercial Enterprises for the period between 2008 and 2018.

The study findings in Table 1 reveal that audit committee size in the state-owned commercial enterprises in Kenya (SOCEs) ranges between 4 and 6 members, with an estimated mean of five (*mean=5.11*) members. Further, the results show that the number of independent members in audit committees varied between 2 and 5 members with an estimated mean of 2 (*mean=2.95*) members while those with accounting/finance

expertise 1 and 3 members with a mean of 2 (*mean=1.81*) members. The results further indicate during the study period, the number of audit committee meetings held in a year ranged between 3 and 9 with a mean of 6 (*mean=6.46*) meetings in year.

Table 1: Descriptive Statistics for Audit Committee Attributes

Variable	N	Mean	S.D.	Min	Mdn	Max
Audit Committee Independence	1342	2.95	0.63	2	3	5
Audit Committee Qualification	1342	1.81	0.59	1	2	3
Audit Committee Size	1342	5.11	0.49	4	5	6
Audit Committee Meetings	1342	6.46	1.18	3	6	9

Research findings in Table 2 above indicate that the average size of State-owned Commercial Enterprise in Kenya measured using the natural log of total assets ranges between 5.19 and 222.74 with a mean of 18.75 while the profitability ranges between a loss of Kshs. 6.7 million and Kshs. 93 million profits with a mean of Kshs. 1 million profits. The results further indicate that the State-owned Commercial Enterprises faced liquidity challenges with a minimum of 0.02 and a maximum of 79.25 and a mean of 2.31 while a mean growth rate during the period was 12.5 percent.

Table 2: Descriptive Statistics for Firm Characteristics

Variable	N	Mean	S.D.	Min	Mdn	Max
Firm Size	1342	18.75	8.92	5.19	17.38	222.74
Firm Profitability	1342	1.00E+09	7.80E+09	-6.70E+09	8.30E+05	9.30E+10
Firm Liquidity	1342	2.31	5.63	0.02	1.76	79.25
Firm Growth	1342	12.15	35.75	-543	13.2	1031.8

4.1.1 Correlation between Audit Committee Attributes and Firm Characteristics

The relationship between audit committee attributes and firm characteristics was analyzed using Pearson product moment correlation. Audit committee attributes was measured using the audit committee size, independence, qualification and number of meetings held in a financial year while firm characteristics was measured using firm size,

Profitability, Liquidity and Growth. Table 3 show that firm size has statistically significant positive association with audit committee Independence ($r=0.0778$, $p<.05$), audit committee size ($r=0.1285$, $p<0.05$) and number of audit committee meetings held in a year ($r=0.3068$, $p<0.05$) suggesting that the larger the size of the firm, the increase in number of independent audit committee members, number of audit committee members and number of audit committee meetings held in a year. The result further reveals a statistically significant positive association of firm profitability with the qualification of audit committee ($r=0.0925$, $p<0.05$) and number of audit committee meetings held in a year ($r=0.0592$, $p<0.05$) and the size of the firm ($r=0.02126$, $p<0.05$).

Table 3: **Pearson Product-Moment Correlation between AC Attributes and FC**

Variables	AC_IND	AC_QUA	AC_SIZ	AC_MEET	F_SIZ	F_PROF	F_LIQ	F_GRT
AC_IND	1							
AC_QUA	0.2641*	1						
AC_SIZ	0.0105	0.2609*	1					
AC_MEET	-0.0336	0.2085*	-0.0066	1				
F_SIZ	0.0778*	0.2388*	0.1285*	0.3068*	1			
F_PROF	-0.0161	0.0925*	-0.1049*	0.0592*	0.2126*	1		
F_LIQ	-0.0046	-0.1105*	-0.0126	-0.0781*	0.0776*	0.0386	1	
F_GRT	-0.0434	0.014	-0.0036	0.0382	0.0496	-0.0589*	-0.0019	1

*. Correlation is significant at the 0.05 level.

The result reveal statistically significant negative correlation between firm liquidity and audit committee qualification ($r=-0.1105$, $p<0.05$) and between firm liquidity and the number of audit committee meetings held in a year ($r=-0.0781$, $p<0.05$) while it has statistically significant positive correlation with the firm size indicating the larger the firm the more liquid the firm is. In addition, firm growth had statistically significant negative correlation with firm liquidity denoting that an increase in firm liquidity results in a decline in the growth of the firm.

4.1.2 Hypothesis Testing
The objective of the study was to establish the moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. To achieve this objective, the following hypothesis was developed as supported by the analysis of literature and theoretical reasoning.

H₀: *Firm Characteristics has no moderating effect on the relationship between Audit Committee Attributes and Financial Reporting Quality in state-owned commercial*

enterprises in Kenya

Panel regression analysis was used to test the hypothesis to establish the moderating effect of firm characteristics on the relationship between audit committee attributes and financial reporting quality.

4.1.3 Diagnostic tests

Various diagnostic tests including multicollinearity, heteroscedasticity and autocorrelation were conducted.

Multicollinearity

Panel multicollinearity test was conducted to eliminate possibility of having collinear explanatory variables used in the study. Based on the results of Table 4, mean Variance Inflation Factor (VIF) < 10 was observed indicating that the independent variables were not highly correlated, hence absence of multicollinearity.

Table 4: **Multicollinearity Test results (Mean VIF)**

Model	VIF
Model 1a	1.00
Model 2a	1.11
Model 1b	1.01
Model 2b	1.00
Model 1c	1.06
Model 2c	1.04

Serial Correlation Test

Wooldridge test for autocorrelation in panel data was used and null hypothesis was that there is no serial correlation. Results of Wooldridge test (Table 5) indicate that the problem of autocorrelation is not present.

Table 5:   **Wooldridge Test for Autocorrelation**

Model	Test Statistic	Prob > F
Model 1a	0.496	0.4828
Model 2a	0.491	0.4850
Model 1b	0.500	0.4808
Model 2b	0.507	0.4779
Model 1c	0.500	0.4808

Model 2c	0.510	0.4769

Null Hypothesis: There is no serial correlation

Panel Model Regression Results

The moderating effect on the relationship between audit committee attributes and financial reporting quality in state-owned commercial enterprises in Kenya was computed using Baron and Kenny (1986) approach where the following steps for testing moderating effect were adopted. Step 1: Estimating the relationship between dependent variable and independent variable (model 1) using panel regression analysis as guided by Hausman test and the model should be statistically significant. Step 2: An interaction term was introduced by multiplying centered independent variable and centered moderator. Centering was achieved by subtracting mean from a variable and estimating the relationship between dependent variable, independent variable, the moderator and the interaction term (model 2) to determine and check whether the moderator variable alters the strength of the causal relationship.

Moderating Effect Estimation Models

In model 1a and model 2a, audit committee independence was used as proxy for audit committee attributes while firm liquidity applied as proxy for firm characteristics. In model 1b and model 2b, audit committee independence used as proxy for audit committee attributes while firm size was used as proxy for firm characteristics. In model 1c and model 2c, audit committee qualification was used as proxy for audit committee attributes while firm size was used as the proxy for firm characteristics. Additional four hypotheses were derived from the above hypothesis and tested.

H_{01}: *Firm Liquidity has no moderating effect on the relationship between Audit Committee Independence and Financial Reporting Quality in State-owned Commercial Enterprises in Kenya*

H_{02}: *Firm Size has no moderating effect on the relationship between Audit Committee Independence and Financial Reporting Quality in State-owned Commercial Enterprises in Kenya*

H_{03}: *Firm Size has no moderating effect on the relationship between Audit Committee Qualifications and Financial Reporting Quality in State-owned Commercial Enterprises in Kenya*

H_{04}: *Firm Growth has no moderating effect on the relationship between audit committee size and financial reporting quality in state-owned commercial enterprises in Kenya*

In step 1 (model 1a), the Random Effect model estimator was used to estimate the relationship between audit committee independence, firm liquidity and financial reporting quality. The result of panel regression analysis is presented in Table 6. The results from the Wald Chi-Square test indicate that model 1a as a whole was (all the predictors' regression coefficients taken jointly) significant (*Prob > chi2<0.05*). Furthermore, audit committee independence ($\beta= 0.0113, p<0.1$) and firm liquidity ($\beta= 0.000177, p<0.01$) are significant predictors of financial reporting quality, firm liquidity has significant moderating effect on the relationship between audit committee attributes and financial reporting quality. R-squared (R^2) was 0.0309, which suggests that audit committee independence (independent variable) and firm liquidity (moderator) jointly accounted for 3.09% of the variance in financial reporting quality (dependent variable).

Table 6: **Moderating effect estimation models, Dependent Variable: FRQ, Independent Variable: Audit Committee Characteristics (AC_IND), and Firm Characteristics (moderator)**

Model	Audit Committee Attributes (Predictor/IV)	Firm Characteristics (Moderator)	Interaction Term
Model 1a	AC_IND	F_LIQ	
Model 2a	AC_IND	F_LIQ	AC_IND*F_LIQ
Model 1b	AC_IND	F_SIZE	
Model 2b	AC_IND	F_SIZE	AC_IND*F_SIZ
Model 1c	AC_QUA	F_SIZE	
Model 2c	AC_QUA	F_SIZE	AC_QUA*F_SIZ
Model 1d	AC_SIZ	F_GRT	
Model 2d	AC_SIZ	F_GRT	ACSIZ*FGRT
Model 1e	AC_SIZ	F_PROF	
Model 2e	AC_SIZ	F_PROF	ACSIZ*FPROF
Model 1f	AC_MEET	F_PROF	
Model 2f	AC_MEET	F_PROF	ACMEET*FPROF
Model 1g	AC_MEET	F_GRT	
Model 2g	AC_MEET	F_GRT	ACMEET*FGRT

In step 2 (model 2a), the interaction term was introduced in the panel regression model. Random Effect model was conducted to estimate the relationship between audit committee independence (independent variable), firm liquidity (moderator), audit committee independence multiplied by firm liquidity (interaction term) ($\beta= 0.000128$) and financial reporting quality (dependent variable). The results of panel regression analysis are presented in Table 7. The results from the Wald Chi-Square test indicate that

model 2a as a whole is (all the predictors' regression coefficients taken jointly) significant (*Prob > chi2<0.05*). Furthermore, audit committee independence (*β= 0.0113, p<0.1*) and firm liquidity (*β= 0.000177, p<0.01*) are significant predictors of Financial Reporting Quality. The interaction term (Audit Committee Independence multiplied by Firm Liquidity) was not statistically significant (*p>0.05*). R-squared (R²) was 0.0313 which suggests that Audit Committee Independence (independent variable), Firm Liquidity (moderator) and the interaction term (audit committee independence multiplied by firm liquidity) jointly accounted for 3.13% of the variance in financial reporting quality (dependent variable). The R^2 changed from 0.0309 to 0.0313 in model 2a. The predictor and moderator are significant with the interaction term added, and therefore, we conclude that firm liquidity moderates the relationship between audit committee attribute (AC_IND) and financial reporting quality and therefore, the null hypothesis is rejected.

Table 7: Panel Random–Effects Regression Results, Dependent Variable: FRQ, Predictors: Audit Committee Characteristics (AC_IND) and Firm Characteristics (F_LIQ)

VARIABLES	(1) Model 1a	(2) Model 2a
AC_IND	0.0113*	0.0113*
	(0.00607)	(0.00606)
F_LIQ	0.000177***	0.000177***
	(1.91e-05)	(1.36e-05)
AC_IND*F_LIQ		0.000128
		(9.96e-05)
Constant	0.101***	0.101***
	(0.0179)	(0.0179)
Observations	1,165	1,165
R-Squared	0.0309	0.0313
Wald chi2(2)	96.66	187.64
Prob > chi2	0.0000	0.0000
Number of SOCE_ID	108	108

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Source: Research Data, 2020

H_{02}: *Firm Size has no moderating effect on the relationship between Audit Committee Independence and Financial Reporting Quality in State-owned Commercial Enterprises in Kenya*

In step 1 (model 1b), panel Random Effect model was run to estimate the relationship

between audit committee independence, firm size and financial reporting quality. The results of panel regression analysis are presented in Table 8 from the Wald Chi-Square test indicate that model 1b as a whole was (all the predictors' regression coefficients taken jointly) not significant. Furthermore, audit committee independence (β= 0.0113, p<0.1) was statistically significant. Firm size (β= 2.62e-05) was not statistically significant. R-squared (R^2) was 0.0253, which suggests that audit committee independence (independent variable) and firm size (moderator) jointly accounted for 2.53% of the variance in financial reporting quality (dependent variable).

In step 2 (model 2b), the interaction term was introduced in the panel regression model and Random Effect model was run to estimate the relationship between audit committee independence (independent variable), firm size (moderator), audit committee independence multiplied by firm size (interaction term) and financial reporting quality (dependent variable). The results from the Wald Chi-Square test as presented in Table 8 indicate that model 2a as a whole is (all the predictors' regression coefficients taken jointly) not significant.

Table 8: Panel Random–Effects Regression Results, Dependent variable: FRQ, Predictors: Audit Committee Characteristics (AC_IND) and Firm Characteristics (F_SIZE)

	(1)	(2)
VARIABLES	Model 1b	Model 2b
AC_IND	0.0113*	0.0113*
	(0.00608)	(0.00608)
F_SIZE	2.62e-05	2.70e-05
	(3.65e-05)	(3.77e-05)
AC_IND*F_SIZ		2.54e-05
		(9.71e-05)
Constant	0.101***	0.101***
	(0.0180)	(0.0180)
Observations	1,165	1,165
R-Squared	0.0254	0.0253
Wald chi2(2)	3.91	3.90
Prob > chi2	0.1414	0.2724
Number of SOCE_ID	108	108

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

The results further show that audit committee independence (β= 0.0113, p<0.1) has significant influence on financial reporting quality. The relationship between firm size

(β= 2.70e-05) and financial reporting quality is not statistically significant and therefore we conclude that firm liquidity has no moderating effect on financial reporting quality based on study results. The interaction term (audit committee independence multiplied by firm size) (β= 2.54e-05) was not statistically significant. R-squared (R²) was 0.0253 which suggests that AC_IND (independent variable), F_SIZE (moderator) and the interaction term (β= 2.54e-05) jointly accounted for 2.53% of the variance in financial reporting quality (dependent variable). The change in R^2 was insignificant. Firm size therefore, has no moderating effect on the relationship between audit committee attribute (AC_IND) and financial reporting quality and we fail to reject the null hypothesis.

H_{03}: *Firm Size has no moderating effect on the relationship between Audit Committee Qualifications and Financial Reporting Quality in state-owned commercial enterprises in Kenya*

In step 1 (model 1c), panel Random Effect model was run to estimate the relationship between audit committee qualification, firm size and financial reporting quality and the results from the Wald Chi-Square shown in Table 9 test indicate that model 1c as a whole was (all the predictors' regression coefficients taken jointly) not significant.

Table 9: Panel Random–Effects Regression Results, Dependent Variable: FRQ, Predictors: Audit Committee Attributes (AC_QUA) and Firm Characteristics (F_SIZE)

	(1)	(2)
VARIABLES	Model 1c	Model 2c
AC_QUA	-0.0109*	-0.0109*
	(0.00627)	(0.00627)
F_SIZ	2.71e-05	2.90e-05
	(3.65e-05)	(4.04e-05)
AC_QUA*F_SIZ		3.14e-05
		(0.000111)
Constant	0.153***	0.153***
	(0.0113)	(0.0113)
Observations	1,165	1,165
R-Squared	0.0223	0.0221

Wald chi2(2)	3.61	3.60
Prob > chi2	0.1647	0.3075
Number of SOCE_ID	108	108

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Furthermore, audit committee qualification (*β= -0.0109, p<0.1*) had statistically significant and negative influence on financial reporting quality while firm size (*β= 2.71e-05*) was not statistically significant. R-squared (R²) was 0.0223 implying that audit committee qualification and firm size jointly accounted for 2.23% of the variance in financial reporting quality. In step 2 (model 2c), the interaction term was introduced in the panel regression model. Random Effect model was run to estimate the relationship between audit committee qualification (independent variable), firm size (moderator), audit committee qualification multiplied by firm size (interaction term) and financial reporting quality (dependent variable). The results from the Wald Chi-Square (Table 9) test indicate that model 2c as a whole is (all the predictors' regression coefficients taken jointly) not significant. The regression coefficient of audit committee qualification *(β= -0.0109, p<0.1)* was however statistically significant while the relationship between firm size (*β= 2.90e-05*) and financial reporting quality was not statistically significant and therefore we conclude that firm liquidity has no significant effect on financial reporting quality based on study results. The interaction term (audit committee qualification multiplied by firm size) (*β=3.14e-05*) was not statistically significant. R-squared (R²) was 0.0221, which suggests that audit committee qualification (independent variable), firm size (moderator) and the interaction term jointly account for 2.21% of the variance in financial reporting quality (dependent variable). The change in R^2 was very small (*0.0223 to 0.0221*). We therefore, fail to reject the null hypothesis.

H_{04}: *Firm Growth has no moderating effect on the relationship between audit committee size and financial reporting quality in state-owned commercial enterprises in Kenya.*

In step 1 (model 1d), the Random Effect model estimator was used to estimate the relationship between audit committee size (AC_SIZ), firm growth (F_GRT) and financial reporting quality (FRQ). The panel regression analysis results (Table 10) from the Wald Chi-Square test shows that model 1d as a whole is (all the predictors' regression coefficients taken jointly) not significant (*P-value>0.05*). Furthermore, audit committee size (*β= -0.00969*) and firm growth (*β= 0. 1.16e-06*) have no significant effect on financial reporting quality. R-squared (R²) was 0.0122 suggesting that audit committee size (independent variable) and firm growth (moderator) jointly account for 1.22% of the variance in financial reporting quality (dependent variable).

In step 2 (model 2d), the interaction term was introduced in the panel regression model and Random Effect model was ran to estimate the relationship between audit committee size (independent variable), firm growth (moderator), audit committee size multiplied by firm growth (interaction term) and financial reporting quality (dependent variable). The results (Table 10) from the Wald Chi-Square test indicate that model 2d as a whole is (all the predictors' regression coefficients taken jointly) not significant (*P-value>.05*). Moreover, audit committee size (*β= -0.00966*) and firm growth (*β= 1.69e-06*) are not significant predictors of financial reporting quality. The interaction term (AC_SIZ*F_GRT) was not statistically significant (*β=1.12e-05*).

Table 10: Panel Random–Effects Regression Results, Dependent Variable: FRQ, Predictors: Audit Committee Attributes (AC_SIZ) and Firm Characteristics (F_GRT)

VARIABLES	(1) Model 1d	(2) Model 2d
AC_SIZ	-0.00969	-0.00966
	(0.00666)	(0.00667)
F_GRT	1.16e-06	1.69e-06
	(1.36e-06)	(1.45e-06)
AC_SIZ_FGRT		1.12e-05
		(1.09e-05)
Constant	0.184***	0.184***
	(0.0347)	(0.0347)
Observations	1,165	1,165
R-Squared	0.0122	0.0123
Wald chi2 (3)	2.73	3.67
Prob > chi2	0.2557	0.3000
Number of SOCE_ID	108	108

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

R-squared (R²) was 0.0123 indicating that audit committee size (independent variable),

firm growth (moderator) and the interaction term (AC_SIZ*F_GRT) jointly accounted for 1.23% of the variance in financial reporting quality (dependent variable). The R^2 change was negligible (model 2d). The predictor and moderator are not significant with the interaction term added, and therefore we conclude that firm growth does not moderate the relationship between audit committee attribute (AC_SIZ) and financial reporting quality and therefore, we fail to reject the hypothesis.

5.1 Discussion

The study sought to determine impact of Firm Characteristics on the association of AC Attributes with FRQ of SOCEs. Firm Size, Liquidity, Growth and Profitability were used as indicators for Firm Characteristics; Independence, Qualification, Size, and Meetings conducted a year represented Audit Committee Attributes while Accrual Quality, Qualitative Characteristics and Timeliness Reporting were employed as barometers for Financial Reporting Quality. In step 1 (model 1a), the Random Effect model estimator was used to estimate the connection between AC Independence, Firm Liquidity and FRQ and the results from the Wald Chi-Square test indicate that model 1a as a whole was (all the predictors' regression coefficients taken jointly) significant (Prob > chi2<0.05). Furthermore, Audit Committee Independence ($\beta = 0.0113$, $p < 0.1$) and Firm Liquidity ($\beta = 0.000177$, $p < 0.01$) are notable predictors of financial reporting quality. R-squared (R^2) was 0.0309 which suggests that Audit Committee Independence (independent variable) and Firm Liquidity (moderator) jointly account for 3.09% of the variance in financial reporting quality.

In step 2 (model 2a), the interaction term was introduced in the panel regression using Random Effect model and the results from the Wald Chi-Square test indicate that model 2a as a whole was (all the predictors' regression coefficients taken jointly) significant (Prob > chi2<0.05). Similarly, AC Independence ($\beta = 0.0113$, $p < 0.1$) and Firm Liquidity ($\beta = 0.000177$, $p < 0.01$) were notable interpreter of Financial Reporting Quality while Audit Committee Independence multiplied by Firm Liquidity was insignificant ($p>0.05$). R-squared (R^2) was 0.0313 which suggests that Audit Committee Independence (independent variable), Firm Liquidity (moderator) and the interaction term (Audit Committee Independence multiplied by Firm Liquidity) jointly accounted for 3.13% of the variance in Financial Reporting Quality (dependent variable). The R^2 changed from 0.0309 to 0.0313 in model 2a. The predictor and moderator are significant with the interaction term added, and therefore we concluded that Firm Liquidity moderates the association of AC attributes with FRQ and the null hypothesis is rejected. The results were irreconcilable with those of Oluwokore et al. (2015) who suggested that there was insignificant connection between firm leverage and financial reporting quality. However, Alsaeed (2006) posit that firm profitability influenced financial reporting and that firms that held frequent audit committee meetings reduced financial reporting challenges.

On the other hand, model 2b applied panel Random Effect model to estimate the linkage of AC Independence, Firm Size and FRQ yielding results using Wald Chi-Square tests exhibited that model 1b as a whole was (all the predictors' regression coefficients taken jointly) not significant. Moreover, AC Independence (β= 0.0113, p<0.1) was statistically significant while Firm Size (β= 3.65e-05, p>0.01) was insignificant. R-squared (R^2) was 0.0254 suggesting that Audit Committee Independence (independent variable) and Firm Size (moderator) jointly accounted for about 2.54% of the variance in financial reporting quality (dependent variable).

In addition, an interaction term was introduced in model 2b in the panel regression where the relationship between Audit Committee Independence (independent variable), Firm Size (moderator), Audit Committee Independence multiplied by Firm Size (interaction term) and Financial Reporting Quality (dependent variable) was estimated and the results intimated that the whole model (all the predictors' regression coefficients taken jointly) was not significant. Equally important, AC Independence (β= 0.0113, p<0.1) had significant influence on Financial Reporting Quality whereas Firm Size (β= 2.70e-05, p>0.01) showed no statistically significant relationship with FRQ thereby concluding that Firm Size had no effect on Financial Reporting quality based on study results. Notably, the interaction term (Audit Committee Independence multiplied by Firm Size) was not statistically significant (p>0.05).   By the same token, R-squared (R^2) was 0.0253 which suggested that AC_IND (independent variable), F_SIZE (moderator) and the interaction term (0.0253) jointly accounted for 2.53% of the variance in financial reporting quality (dependent variable) resulting in insignificant change in R^2.

In view of the results, Firm Size had no moderating impact on the interrelation of AC Characteristics with FRQ; hence we fail to reject the hypothesis. Research findings show that firm size as an indicator of firm characteristics did not moderate the interrelation among AC attributes and FRQ which displayed consistency with that of Aljifri et al. (2014) who found that firm size listing status and industry type impacted positively on the connection AC independence and FRQ. This equally is supported by previous empirical evidence on the studies conducted by other scholars (Klein, 2002b; Yang & Krishnan, 2005; Davidson, Stewart & Kent, 2005).

Further analysis using Random Effect in model 1c to estimate the relationship among AC Qualification, Firm Size and FRQ using Wald Chi-Square test indicated that model 1c as a whole was (all the predictors' regression coefficients taken jointly) not significant. Whereas the results showed that Audit Committee Qualification (β= -0.0109, p<0.1) was statistically significant, an indication that Audit Committee Qualification had an adverse but plausible influence on FRQ, on the contrary Firm Size (β= 2.71e-05, p>0.01) was not

statistically significant. R-squared (R²) was 0.0223 revealing that Audit Committee Qualification (independent variable) and Firm Size (moderator) jointly accounted for 2.23% of the variance in financial reporting quality.

Comparatively, model 2c used regression model to estimate the connection amongst Audit Committee Qualification (independent variable), Firm Size (moderator), Audit Committee Qualification multiplied by Firm Size (interaction term) and FRQ. The results of panel regression indicated that model 2c as a whole was (all the predictors' regression coefficients taken jointly) not significant. While the regression coefficient of AC qualification (β= -0.0109, p<0.1) showed statistical significance, however, relationship between Firm Size (β= 2.90e-05, p>0.05) and Financial Reporting Quality was insignificant and therefore we infer that Firm Size had no significant effect on FRQ. Likewise, the interaction term (AC Qualification multiplied by Firm Size) exhibited non-statistical significance (p>0.05). Additionally, R-squared (R²) was 0.0221 which suggested that Audit Committee Qualification (independent variable), Firm Size (moderator) and the interaction term jointly account for 2.21% of the variation in FRQ and the change in R^2 was insignificant.

In their study, Madawaki and Amran (2013) found a conclusive association amongst firms with independent AC chair and members with accounting or financial knowledge and FRQ and that firm size did not influence that relationship and affirms the study outcomes. However, the results were contrary to those of Jennifer (2014) who found a direct link between firm indicators and FRQ but failed to indicate the effect of specific firm characteristics linking the relations among AC attributes and FRQ.

In step 1 (model 1d), the Random Effect model estimator was applied to estimate the interrelation amongst AC Size (AC_SIZ), Firm Growth (F_GRT) and FRQ. Findings of panel regression analysis are as shown in Table 5.20. Results from the Wald Chi-Square test indicate that model 1d as a whole was (all the predictors' regression coefficients taken jointly) not significant (P-value>0.05). Furthermore, Audit Committee Size (β = -0.00969, p>0.05) and Firm Growth (β= 0. 1.16e-06, p>0.05) had insignificant impact on financial reporting quality. R-squared (R²) was 0.0122 suggesting that Audit Committee Size (independent variable) and Firm Growth (moderator) jointly account for 1.22% of the variation in Financial Reporting Quality (dependent variable).

Introduction of an interaction term (Firm Growth) in model 2d using Random Effect in testing the interdependence amongst Audit Committee Size (independent variable), Firm Growth (moderator), Audit Committee Size multiplied by Firm Growth (interaction term) and Financial Reporting Quality revealed that the whole model 2d (all the predictors' regression coefficients taken jointly) was insignificant (P-value>.05) when Wald

Chi-Square test was applied. Moreover, AC Size (β= -0.00966, p<0.1) and Firm Growth (β= 1.69e-06, p>0.05) also exhibited non-significance predictors of Financial Reporting Quality. The interaction term (AC_SIZ*F_GRT) also was insignificant (p>0.05). R-squared (R²) was 0.0123 which showed that Audit Committee Size (independent variable), Firm Growth (moderator) and the interaction term (AC_SIZ*F_GRT) jointly accounted for 1.23% of the variance in financial reporting quality (dependent variable) and change in R^2 was negligible in the model 2d.

It was evident the predictor (Audit Committee Size) and moderator (Firm Growth) were not significant with the interaction term added, Firm Growth doesn't moderate the relationship between AC Attribute (AC_SIZ) and FRQ and therefore, we fail to reject the hypothesis. The study findings found to be consistent with prior studies (Jennifer, 2014; Madawaki & Amran, 2013; Klein, 2002b) who found that form growth did not influence the connection AC size with FRQ. This positively confirms that SOCEs with high growth rate will automatically not influence the relationship FRQ and the size of the AC.

5.2 Conclusion

The findings also indicates that firm characteristics did not moderate the relationship between financial reporting quality in state-owned commercial enterprises in Kenya. Results further revealed that firm liquidity moderated the relationship between audit committee independence and financial reporting quality while firm size and growth did not moderate the relationship between audit committee independence, qualification and size with financial reporting quality. We therefore, conclude that firm characteristics does not moderate the relationship between audit committee attributes and financial reporting quality in state-owned commercial enterprises in Kenya.

Researchers could build on the results of this study and conduct future research by incorporating all state-owned entities and also including the period before 2008 to see the outcome.

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