

**AUDIT COMMITTEE CHARACTERISTICS AND EARNINGS QUALITY IN
TIER ONE BANKS IN NAIROBI CITY COUNTY, KENYA.**

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DECLARATION

This project is novel, and it has never been evaluated for an award at another university.

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DEDICATION

This endeavor is dedicated to those individuals who have consistently provided me with unflinching support during this journey: my loving spouse, whose encouragement has been my motivation; my parents, whose belief in my potential paved the way for my pursuit of knowledge; my siblings, my lifelong companions who provided inspiration and camaraderie; my cherished friends and associates, whose discussions and insights enriched my perspective; and my distinguished supervisor, whose assistance and mentorship have played a crucial role in defining this research. I highly appreciate your valuable input and I deeply appreciate your being in my life.

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OPERATIONAL DEFINITION OF TERMS

| | |
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| Audit Committee | Their responsibilities are to oversee the financial reporting process, internal control systems, external audit process, and risk management of the organization. |
| Audit committee characteristics | They refer to the specific features and composition of the audit committees. These characteristics include committee size, member independence, financial expertise, meeting frequency, and other relevant attributes that define how the audit committee operates. These factors are essential for evaluating the audit committee's efficacy in overseeing financial reporting and ensuring earnings quality in the banking sector. |
| Earnings Quality | Earnings quality is the reliance and usefulness of reported earnings, as measured by accrual quality and earnings timeliness. Accrual quality assesses the extent to which reported earnings reflect actual cash flows, while earnings timeliness captures the |

velocity at which reported earnings reflect changes in a company's underlying economic performance.

Size of the Audit Committee

The number of members on the audit committee. This can be measured by counting the number of individuals who are appointed to the audit committee.

Audit Committee Meetings Frequency

The frequency of audit committee meetings, typically on an annual basis. This can be quantified by tallying the frequency of convened gatherings.

Role of the Audit Committee

The responsibilities and functions of the audit committee, which include overseeing financial reporting, internal control systems, external audit process, and risk management.

Tier one Banks

Tier One Banks are classified as Tier One banks based on regulatory criteria set forth by the relevant financial regulatory authorities. These criteria typically include measures of a bank's capital adequacy, asset quality, and financial stability. Tier One banks are recognized for their strong

financial health and capacity to meet regulatory requirements, making them integral players in the nation's banking industry.

Composition of the Audit Committee

The characteristics of the individuals who serve on the audit committee, such as their skills, proficiency, industry experience, and independence. This can be measured by reviewing the biographical data of the audit committee members.

ABBREVIATION AND ACRONYMS

| | |
|-------------|---|
| NCC | Nairobi City County |
| GAAP | Generally accepted accounting principles |
| CMA | Capital markets authority |
| SPSS | Statistical package for the social sciences |

ABSTRACT

The study investigates the correlation between audit committee characteristics and earnings quality in tier one banks in Nairobi City County, Kenya. The research addresses the research problem of determining which specific audit committee characteristics influence earnings quality in these banks. The study focuses on four key audit committee characteristics: composition, size, meetings frequency, and the role of the audit committee. The research employs a correlational design to ascertain the connection between the audit committee characteristics and the earnings quality. The target population includes six tier one banks in Nairobi City County. Data is collected through questionnaires administered to management at operational, middle, and lower levels. The study utilizes regression analysis to analyze the collected data. Key findings from the study indicate that audit committee composition, particularly the presence of independent directors, financial experts, and industry experts, is positively linked with earnings quality. Audit committee size and meetings frequency also demonstrate a positive relationship with earnings quality. Furthermore, increased involvement exhibited by the audit committee in financial reporting oversight is linked to higher earnings quality. The study recommends that companies carefully consider the composition, size, meetings frequency, and role of their audit committees to enhance earnings quality. Appointing independent directors with financial and industry expertise, maintaining an optimal audit committee size, holding regular meetings, and ensuring an active oversight role are crucial for effective audit committees. This study enhances the current body of knowledge on the effectiveness of audit committees and the quality of earnings. It also offers valuable insights for policymakers, regulators, and professionals in the banking industry. Subsequent investigations should investigate the influence of audit committee attributes on additional dimensions of corporate governance and analyze these associations in diverse geographical settings.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

In the modern business landscape, the stability and efficiency of the financial sector are of paramount importance. The Basel Committee on Banking Supervision (2013) emphasizes the fundamental relevance of effective corporate governance in maintaining the stability of the banking industry and protecting stakeholders, including depositors. Audit committees are an essential part of corporate governance and have a crucial responsibility in supervising financial reporting procedures, internal controls, and risk management (Bhagat and Courmier, 2008).

Zooming in on the specific characteristics of audit committees, factors such as composition, size, meeting frequency, and the role of the committee have been identified as critical determinants of their effectiveness in promoting good governance and financial reporting quality (O'Brian, 2009). Empirical evidence indicates that organizations with robust audit committees typically exhibit superior financial reporting methods, internal controls, and corporate governance systems (Chen et al., 2011). Conversely, weak audit committees have been associated with lower earnings quality, less effective internal controls, and weaker corporate governance (Liu, 2014).

In the context of Kenya's financial sector, the significance of audit committees in guaranteeing the honesty and dependability of financial reporting cannot be exaggerated. Kenya's banking sector has experienced significant growth and development in recent

years, with Tier One banks playing a pivotal role in the country's economy. These banks, characterized by their size, market share, and systemic importance, have a substantial impact on the constancy and growth of the financial system (Mwangi, 2016; Kimani and Ndung'u, 2017).

However, there are questions over the precision and dependability of financial reporting and the efficiency of audit committees in Kenya's banking industry. Instances of financial misreporting and fraudulent activities have been observed, highlighting the need for robust corporate governance mechanisms (Mutuku and Nzulwa, 2021). The Capital Markets Authority (2019) has reported that only a small percentage of listed companies in Kenya meet the minimum requirements for financial reporting quality, further underscoring the urgency of addressing this issue.

Though audit committees serve a crucial part in guaranteeing the accuracy of financial reporting, there is a dearth of empirical data about the correlation between audit committee characteristics and the reliability of profits in Tier One banks located in Nairobi City County, Kenya. This research gap is particularly significant given the importance of these banks to the Kenyan economy and the need for effective corporate governance practices to maintain financial stability and protect stakeholders' interests.

By adopting a funnel approach, the background of the study now starts with a broad discussion of the importance of corporate governance and audit committees in the financial sector, then centers on the precise attributes of audit committees and their influence on the

caliber of financial reporting. It further zooms in on the Kenyan context, highlighting the importance of Tier One banks and the concerns surrounding financial reporting quality. Finally, the research highlights the identification of a research gap and emphasizes the importance of investigating the connection between audit committee features and earnings quality within this particular scenario.

1.1.1 Audit Committees

In recent times, the significance of the audit committee's part in enhancing solid corporate governance has become more apparent. Originating in the U.S. during the 1930s as a countermeasure to the 1929 stock market collapse and the corporate discrepancies that ensued, audit committees aimed to serve as protectors for shareholders by verifying the consistency and dependability of financial declarations.

Over the years, the responsibilities of the audit committee have expanded, positioning it as an essential pillar of robust corporate governance. This committee bridges the communication between the board of directors, the managerial team, and the third-party auditor, fortifying the integrity and clarity of financial disclosures. Additionally, they oversee the internal regulatory systems and review the work of the external auditor.

Research indicates that entities boasting efficient audit committees generally exhibit superior financial declaration quality, advanced governance standards, and enhanced overall output. For instance, research by Kim, Park, & Suh in 2014 revealed a positive

correlation between competent audit committees and financial declaration quality, with such organizations demonstrating optimal overall functionality.

Considering the audit committee's pivotal role in fortifying corporate governance and refining financial declaration standards, it becomes imperative to probe the elements driving the audit committee's efficiency. Factors such as its makeup, magnitude, meeting regularity, and function play crucial roles in determining its effectiveness. Delving into these elements is vital for ameliorating financial disclosure standards and fostering commendable governance within corporations.

1.1.2 Earnings Quality

The integrity of earnings is pivotal to financial disclosures and serves a central part in bolstering the efficiency of capital markets and maintaining the equilibrium of the financial structure. It encompasses the precision, comprehensiveness, and dependability of financial declarations and stands as an indicator of the caliber of financial disclosures. The essence of earnings integrity is emphasized by its ability to convey genuine and consistent information to involved parties.

For the investment community, the excellence of earnings is indispensable for judicious decision-making. These investors lean on financial reports to gauge an enterprise's economic health and prospective growth. Flawed financial disclosures can skew investment judgments, potentially leading to notable repercussions on investors' assets.

Additionally, the sanctity of earnings holds significance for regulatory bodies. Tasked with upholding the harmony and proficiency of the financial domain, regulators emphasize the necessity of truthful and consistent financial disclosures. Elevated earnings integrity aids regulators in pinpointing fiscal discrepancies within firms, thus offering a preventive measure against potential cascading disruptions within the financial sector.

In a study by Ball and Shivakumar in 2005, it was observed that the integrity of earnings greatly influences the capital expenditure. They deduced that as the perceived risk linked with subpar financial reports rises, investors seek greater returns. Consequently, enterprises exhibiting stellar earnings integrity often experience a more favorable capital expenditure rate. This high caliber of earnings is also correlated with other superior financial disclosure standards.

1.1.3 Tier One Banks in Kenya

The selection of Tier One commercial banks as the focal point of this study is substantiated by several compelling reasons. Firstly, within Kenya's financial landscape, Tier One commercial banks hold a preeminent position. These banks are characterized by their substantial size, extensive reach, and a history of stability and reliability. Their prominence is underlined by a strong reputation and a vast customer base, making them central players in the nation's banking sector.

Secondly, the influence of Tier One banks extends far beyond their individual operations. They are pivotal entities within Kenya's economy, actively shaping its trajectory. As evidenced by research, Tier One banks in Kenya have a substantial impact on the country's

economic dynamics. For instance, a study conducted by Mwangi (2016) revealed that these banks were responsible for a significant portion of private sector lending, underscoring their critical role in facilitating economic growth and development. Furthermore, research by Kimani and Ndung'u (2017) shed light on the profitability of Tier One banks in Kenya, positioning them as regional leaders and agents of economic expansion.

In contrast, Tier Two and Tier Three banks, while important, do not wield the same level of influence on the Kenyan economy. Tier Two banks are typically smaller in size and have a more limited market reach compared to Tier One banks. They often focus on specific regions or market segments, and their impact on the overall economy is relatively modest. Similarly, Tier Three banks are generally the smallest in size and have a more localized presence. Although they serve an essential part in offering financial services to underserved communities, their impact on the broader economic landscape is comparatively limited. By focusing on Tier One banks, this study aims to capture the most significant and influential players in Kenya's banking sector. The financial stability and reporting practices of these banks have far-reaching implications for the country's economic well-being. Exploring the link between audit committee characteristics and earnings calibre in Tier One banks is crucial, as any irregularities or weaknesses in their financial reporting can have severe repercussions for the entire financial system. Moreover, Tier One banks are subject to more stringent regulatory requirements and public scrutiny due to their systemic importance. They are expected to adhere to the highest standards of corporate governance and financial reporting. Therefore, understanding the factors that influence earnings quality in these banks is of utmost importance for policymakers, regulators, and stakeholders.

In summary, the focus on Tier One banks in this study is justified by their dominant position in Kenya's banking sector, their significant contribution to the economy, and the far-reaching consequences of their financial stability and reporting practices. The study endeavors to offer insights that can have the most significant impact on the dependability of financial information and the strengthening of corporate governance in Kenya's banking industry by focusing on these banks.

1.2 Statement of the problem

The delinquent of poor earnings quality has emerged as a pressing concern in Kenya's financial sector in recent times, and a statistical trend underscores the urgency of addressing this issue. Instances of financial misreporting and fraudulent activities have become increasingly prevalent, casting a shadow of doubt over the integrity of financial reporting practices in the country, as highlighted by Mutuku and Nzulwa (2021). Notably, the incidence of such financial irregularities has shown an upward trajectory over the past decade, accentuating the gravity of the problem.

This issue is underscored by empirical evidence gathered through a survey by the Capital Markets Authority, revealing that only 36% of Kenyan listed companies meet the minimum requirements for financial reporting quality (Capital Markets Authority, 2019). This figure represents a significant decline from previous years, where the percentage of compliant companies was notably higher. In 2015, for example, the compliance rate stood at 52%, indicating a worrying downward trend in financial reporting quality (Kariuki and Mwangi, 2017). Such a substantial decrease within a relatively short span of time has sounded the

alarm, emphasizing the critical need for comprehensive research to delve into the underlying causes of these shortcomings in financial reporting.

Moreover, the problem is further compounded by the increasing frequency and magnitude of financial misstatements among Kenyan companies. A study by Outa and Waweru (2019) found that the number of companies restating their financial statements due to errors or irregularities increased by 28% between 2014 and 2018. This concerning pattern highlights the gradual decline in confidence regarding the precision and dependability of financial statements, which can result in significant repercussions for investors, stakeholders, and the general integrity of the financial system.

However, a significant research gap exists in the current landscape. Specifically, there is a dearth of empirical evidence concerning the link between audit committee characteristics and earnings calibre within Tier One banks located in Nairobi City County. Given the pivotal role that these banks play in the Kenyan economy, this research gap is particularly conspicuous. Thus, this research intends to bridge this gap by providing insights into how specific attributes of audit committees impact the caliber of financial reporting.

Tier One banks hold considerable sway within Kenya's financial sector, accounting for a substantial portion of the nation's banking assets (Kenya Bankers Association, 2021). Consequently, any factors influencing the financial reporting quality of these institutions have far-reaching implications for the broader financial stability and economic well-being of Kenya. Understanding the dynamics at play within these influential financial entities is

essential for the promotion of good governance and financial stability within the country's financial sector.

Furthermore, the findings of this research are poised to have tangible relevance for policymaking and regulatory efforts. By offering empirical evidence on the link between audit committee characteristics and earnings quality, this research equips policymakers, regulators, investors, and industry practitioners with the knowledge required to implement effective reforms and governance practices.

In summary, this study addresses a pressing issue within Kenya's financial sector, filling a critical research gap and offering insights that can pave the way for improved governance practices and enhanced financial reporting quality, while acknowledging the alarming statistical trend of declining financial reporting quality over the past decade. Its findings are poised to benefit a broad spectrum of stakeholders, from policymakers and regulators to investors and financial sector practitioners, all of whom are dedicated to advancing the standards of good governance and financial stability in Kenya.

1.3 Research Objectives

1.3.1 General Objective

The overarching objective of the research was to ascertain the dynamics between audit committee attributes and the caliber of earnings within leading banks situated in Nairobi City County, Kenya.

1.3.2 Specific Objective

- i. To ascertain the relationship between the composition of the audit committee and earnings quality in Tier One banks in Nairobi City County, Kenya.
- ii. To investigate the relationship between the size of the audit committee and earnings quality in Tier One banks in Nairobi City County, Kenya.
- iii. To analyze the relationship between the frequency of audit committee meetings and earnings quality in Tier One banks in Nairobi City County, Kenya.
- iv. To evaluate the relationship between the role of the audit committee and earnings quality in Tier One banks in Nairobi City County, Kenya.

1.4 Research Questions

This study seeks answers to the following queries:

- i. In what way does the makeup of the audit committee influence the integrity of earnings in premier banks of Nairobi City County, Kenya?
- ii. How is the magnitude of the audit committee linked to the caliber of earnings in top-tier banks in Nairobi City County, Kenya?
- iii. In what manner does the regularity of audit committee gatherings impact the quality of earnings in leading banks in Nairobi City County, Kenya?
- iv. How does the function of the audit committee shape the quality of reported earnings in first-rate banks in Nairobi City County, Kenya?

1.5 Significance of the Study

The value of this research is underscored by its potential to augment the prevailing body of work concerning the ties between audit committee attributes and the integrity of earnings. The outcomes of this exploration will offer crucial perspectives regarding how distinct features of the audit committee influence earnings quality among premier financial institutions in Nairobi City County, Kenya. Additionally, this inquiry will carry tangible benefits for those devising policies, overseeing industry standards, and industry experts by shedding light on best practices for structuring and operating audit committees within leading banks in Nairobi City County, Kenya.

1.6 Scope of the Study

The research will ascertain the link between the audit committee characteristics and earnings quality in Tier One banks in Nairobi City County, Kenya. The time scope for data gathering for this study will be between 2016-2021. The study will include a review of the existing literature on the topic, as well as an empirical research of the link between audit committee characteristics and earnings quality in Tier One banks in Nairobi City County, Kenya. The data for this research will be collected from financial reports, company websites, and other publicly available sources.

1.7 Limitations of the study

This investigation encounters specific challenges that warrant recognition and mitigation to preserve its outcomes' trustworthiness and accuracy. A primary concern is the restricted data scope, given that the study focuses solely on Tier One financial establishments within

Nairobi City County, Kenya. To address this constraint, proactive steps will be taken to delve into supplementary data avenues. Additionally, the research will encompass a comprehensive time frame, considering historical data to discern trends over time and potentially conducting future studies when more extensive data becomes accessible. Another limitation pertains to the reliance on publicly available data, which may offer only a partial view of the intricate connection between audit committee characteristics and earnings quality within Tier One banks in Nairobi City County. To mitigate this constraint, the study will employ a multifaceted research approach that combines quantitative data analysis with qualitative insights. This methodological diversity aims to offer a more holistic understanding of the research subject, transcending the limitations associated with a single data source.

Furthermore, the study acknowledges the potential for interpretation bias, as the analysis will hinge on the researcher's judgment. To address this limitation, the research will incorporate measures to enhance objectivity. These measures may include inter-rater reliability checks, involving multiple researchers or experts to independently assess the data and compare findings. Sensitivity analysis will also be conducted to gauge the robustness of results across various interpretations and assumptions, thus strengthening the reliability of the study's outcomes.

It is essential to recognize the limitation concerning the generalizability of the findings. The study is primarily centered on Tier One banks in Nairobi City County, Kenya, and may not be universally applicable. To contend with this limitation, the research will explicitly

underscore the specificity of its findings to this particular context and advise caution when attempting to extrapolate results to different regions or financial institutions. This transparency in acknowledging the limitation will ensure that the study's scope and boundaries are clearly defined. Lastly, the study will give priority to ethical considerations so as to maintain the integrity of the research process. This will need gaining informed consent from participants, ensuring confidentiality and privacy of respondents, and following recognized ethical principles for research. By proactively addressing these ethical concerns, the study aims to maintain the trust of participants and the credibility of its findings. In conclusion, the study takes a proactive approach to confront its limitations. By exploring alternative data sources, employing methodological diversity, enhancing objectivity, and transparently articulating the constraints of generalizability, the research aims to overcome these challenges and contribute valuable insights into the link between audit committee characteristics and earnings calibre in Tier One banks in Nairobi City County, Kenya.

1.8 Study Organization.

This document is structured into five distinct chapters. The inaugural chapter, the Introduction, furnishes readers with a backdrop of the investigation and emphasizes prevailing notions associated with audit committee dynamics and their influence on earnings integrity within Nairobi City County's Tier One banking sector. Within this Introduction, the research concerns, gaps in existing literature, objectives of the study, and its relevance are laid out, accompanied by a delineation of the research's boundaries and challenges faced during its undertaking.

The subsequent chapter, the Literature Review, delves deeply into a combined analysis of academic theories and real-world findings concerning the link between audit committee attributes and the quality of earnings in Tier One banking institutions in Nairobi. This is followed by the Research Methodology chapter, which elucidates the approaches and methods employed to fulfill the aims of the investigation. The fourth chapter, titled "Data Analysis and Findings," provides an overview of the results obtained from the data analysis. It includes an interpretation of the findings and a discussion of their implications in regard to the research objectives and current literature. The final chapter, titled "Summary, Conclusions, and Recommendations," summarizes the main discoveries of the study, makes inferences based on the outcomes, and provides suggestions for corporations, regulators, and future research efforts. This chapter also emphasizes the study's additions to the current pool of information and its possible impact on corporate governance practices in the banking industry.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Chapter two delves into both theoretical and real-world studies, shedding light on the nexus between audit committee attributes and the quality of earnings. This segment will traverse various philosophical underpinnings and practical notions linked to audit committees and their pertinence to earnings integrity. Moreover, the chapter will critically appraise prior academic endeavors, emphasizing their findings and potential shortcomings related to the influence of audit committee traits on earnings robustness. An integrated conceptual scaffold will be unveiled, weaving the discussed ideologies and practicalities, demarcating the essential elements and associations for further examination. This blueprint will subsequently anchor the empirical scrutiny of the interplay between audit committee features and earnings quality in the ensuing sections.

2.2 Theoretical Review

This section delves into four prominent theories that shape the understanding of audit committees and earnings quality: Agency Theory, Signaling Theory, Stakeholder Theory, and Institutional Theory. The key concepts and propositions of these theories, along with their seminal contributions to the field, will be examined and critiqued in the following subsections.

2.2.1 Agency Theory

Berle and Means, in 1932, shed light on Agency Theory, elucidating the dichotomy between firm ownership and its governance. This perspective postulates the influential role of audit committees as oversight entities, bridging the potential schism between managerial aspirations and shareholder interests (Jensen & Meckling, 1976). From this vantage, it's not uncommon to find managerial objectives diverging from shareholder interests, often manifesting in pursuits of personal remuneration or job tenure assurances.

In such scenarios, the mantle falls upon audit committees. Their remit encompasses the diligent surveillance and governance of managerial actions, ensuring alignment with stakeholder welfare (Fama & Jensen, 1983).

Over the chronology of its conceptual evolution, Agency Theory has progressively underscored the paramountcy of audit committees within the ambit of corporate stewardship. To exemplify, the theory has been a beacon in elucidating how these committees augment the integrity of financial disclosures, emphasizing precision and trustworthiness in financial narratives (DeZoort & Salterio, 2001). Moreover, the theory offers insights into the pivotal role of audit committees in mitigating financial deceit by diligently scrutinizing managerial decisions (Beasley, Carcello, Hermanson, & Neal, 2009).

The utilization of Agency Theory in this study is warranted as it offers a structure for comprehending the function of audit committees in reducing potential conflicts of interest between management and shareholders. The approach emphasizes the significance of

overseeing managerial actions to guarantee their conformity with shareholder interests, which constitutes a fundamental role of audit committees. This research aims to analyze the correlation between the features of audit committees and the quality of profits, using the framework of Agency Theory. By doing so, it can offer valuable insights into how audit committees can successfully carry out their supervisory responsibilities and improve the accuracy and dependability of financial disclosures.

2.2.2 Signaling Theory

In 1973, Spence unveiled the Signaling Theory, which delves into the strategies companies employ to relay the calibre of their offerings to a wider external audience. This theoretical framework propounds that inherent attributes of audit committees play a pivotal role as beacons, illuminating for external stakeholders the level of integrity and accuracy inherent in a firm's financial narratives (Healy & Palepu, 2001). To put it in perspective, an audit committee that enjoys a formidable reputation in the industry serves as a testament to prospective investors. It assures them of the firm's unwavering commitment to financial transparency and the dependability of its earnings projections.

The signaling theory has been developed over time to explain how audit committee characteristics can affect earnings quality. For example, the theory has been used to explain how audit committee independence can signal to external stakeholders that the firm's financial reporting is free from management bias (Abbott, Parker, Peters, & Raghunandan, 2003). In addition, the theory has been utilized to elucidate how audit committee expertise

can signal to external stakeholders that the firm has the knowledge and resources to produce high-quality financial reporting (Higgs, 2003).

The research finds relevance in Signaling Theory as it elucidates how the features of an audit committee might work as indicators of the caliber and honesty of a firm's financial reporting. The hypothesis posits that having autonomous, knowledgeable, and esteemed individuals on the audit committee helps communicate to external stakeholders the company's dedication to transparent and dependable financial reporting. This study aims to utilize Signaling Theory to explore the impact of certain features of the audit committee, such as autonomy and expertise, on stakeholders' perception of earnings quality. This rationale supports the incorporation of Signaling Theory into the research.

2.2.3 Stakeholder Theory

Stakeholder Theory, postulated by R. Edward Freeman in 1984, is a management framework that emphasizes the diverse impacts and influences of organizations on various stakeholders. Freeman broadly defines stakeholders to include not only shareholders and employees but also customers, suppliers, communities, and other parties with a vested interest in the organization's performance.

Stakeholder Theory has undergone numerous refinements and extensions over time. Donaldson and Preston (1995) introduced the concept of "normative stakeholder theory," arguing that managers are ethically bound to take into account the concerns and viewpoints of all stakeholders while making decisions. Researchers have also explored the nature of

stakeholder relationships and strategies for effective stakeholder management (Mitchell et al., 1997; Clarkson, 1995).

In the context of the current research, the Stakeholder Theory offers a framework for comprehending the importance of audit committees at top-tier banks located in Nairobi City County. Audit committees serve a vital part in governance by reviewing intricate financial reporting processes and safeguarding the interests of many stakeholders. The research seeks to evaluate the efficacy of audit committees in protecting stakeholder interests and enhancing transparency and integrity in financial reporting by analyzing the attributes of audit committees and their influence on earnings quality.

The application of Stakeholder Theory in this study is justified as it recognizes the diverse interests of various stakeholders in the financial reporting process. Audit committees play a crucial role in ensuring that the interests of shareholders, employees, customers, and other stakeholders are considered and protected in the context of financial reporting. By examining audit committee characteristics through the lens of Stakeholder Theory, this research attempts to provide valuable insights into the most effective approaches by which audit committees can successfully achieve a harmonious equilibrium and adequately represent the diverse interests of many stakeholders. Ultimately, this will enhance the overall standard and dependability of financial disclosures.

2.2.4 Institutional Theory

Institutional Theory, rooted in sociology, has been widely applied to organizational studies. The theory argues that organizations are shaped by and embedded within the broader social and cultural contexts in which they operate. It suggests that organizations adopt and conform to prevailing norms, values, and practices to gain legitimacy and access to resources (Scott, 2008).

The genesis of Institutional Theory can be attributed to the research conducted by Meyer and Rowan (1977), in which they posited that organizations are profoundly shaped by the institutional settings they operate in, which are characterized by prevailing norms and values. This foundational idea highlights the powerful role of institutions in shaping organizational behavior and structure.

Institutional Theory has evolved to incorporate various perspectives and refinements. The concept of "institutional logics" has been familiarized, referring to the dominant cultural beliefs and values that shape organizational behavior (Thornton et al., 2012). The present study applies Institutional Theory to comprehend the dynamics of audit committees within the banking sector of Nairobi City County. It explores how the characteristics and practices of audit committees are influenced by the prevailing institutional norms and pressures in the banking industry. By examining the institutional forces that shape audit committee behavior, this research seeks to offer perspectives on the mechanisms by which these committees navigate and respond to the institutional environment in their role of overseeing financial reporting quality.

The study finds relevance in the application of Institutional Theory, as it offers a structured approach to comprehend the impact of the institutional environment on the behavior of audit committees. The theory suggests that audit committees are shaped by the prevailing norms, values, and practices within the banking industry. By applying Institutional Theory, this study can explore how the institutional context, including regulatory requirements and industry best practices, influences the characteristics and effectiveness of audit committees in ensuring earnings caliber. The incorporation of this theory is warranted as it enables a more thorough comprehension of the elements that influence audit committee behavior and decision-making within the particular setting of the banking industry in Nairobi City County.

2.3 Empirical Review

2.3.1 Composition of the Audit Committee and Earnings Quality

Beasley (2013) researched the impact of audit committee composition on earnings quality. The research discovered a positive correlation between audit committees that had a greater share of independent directors and higher levels of earnings quality. However, the study focused mainly on the independence aspect and did not comprehensively explore other composition factors.

Chung and Kallapur (2019) researched the link between audit committee structure and earnings calibre. They found a positive association between the presence of financial experts on the audit committee and earnings quality. The study was limited by its emphasis on financial expertise, with other composition elements largely unexplored.

Lin et al. (2016) researched the impact of gender diversity on audit committees and its relationship with earnings quality in Taiwanese firms. They found a correlation between the level of gender diversity in audit committees and the quality of profitability in firms. However, the research exclusively examined gender diversity and did not thoroughly investigate other elements related to composition. The applicability of the findings may be restricted due to the particular environment of Taiwanese enterprises.

Carcello et al. (2019) explored the connection between audit committee members' expertise and earnings quality. They observed that organizations having audit committees consisting of individuals with significant financial competence demonstrated superior earnings quality. The study's limitations include its primary focus on expertise, with limited consideration of other composition determinants.

Wang et al. (2018) conducted a study on the impact of audit committee members' tenure on earnings quality in Chinese listed companies. The study revealed a positive correlation between the tenure of audit committee members and the level of profits quality in organizations. Nevertheless, the study largely examined the duration of committee members' service, giving less attention to other factors of their composition. The applicability of the findings may be restricted due to the special circumstances of Chinese listed businesses.

2.3.2 Size of the Audit Committee and Earnings Quality

Khan et al. (2019) researched the connection between audit committee size and earnings quality in firms listed on the Karachi Stock Exchange. The analysis discovered a positive correlation between the size of a company's audit committees and the level of profits quality. The study's weaknesses mostly revolve around its narrow focus on audit committee size, with limited investigation into other committee qualities. Moreover, the results may have limited generalizability due to the peculiar context of the Karachi Stock Exchange.

Huang and Li (2014) explored the connection between audit committee size and earnings calibre in Chinese public traded firm. The researchers discovered a positive connection between the size of audit committees and the level of profits quality. The study's shortcomings mostly revolve around its exclusive focus on the size of audit committees, with limited examination of other committee intricacies. Additionally, the generalizability of the findings may be restricted due to the special setting of Chinese listed firms.

Wang et al. (2017) studied the impact of audit committee size on earnings quality in firms listed on the Shanghai Stock Exchange. They found that companies with larger audit committees had better earnings quality. The study's deficiencies mostly revolve around its narrow emphasis on the size of the audit committee, with limited investigation into other committee characteristics. Additionally, the applicability of the findings may be restricted due to the peculiar circumstances of the Shanghai Stock Exchange.

Gul et al. (2010) examined the connection between audit committee size and earnings quality in firms listed on the Pakistan Stock Exchange. The research discovered a positive correlation between the size of audit committees and the level of profits quality. The study's weaknesses mostly revolve around its narrow emphasis on the size of the audit committee, with limited investigation into other features of the committee. Furthermore, the applicability of the findings may be restricted owing to the peculiar circumstances of the Pakistan Stock Exchange.

Hoang and Soufani (2013) investigated the impact of audit committee size on earnings quality in UK-listed firms. They found that firms with larger audit committees tended to have improved earnings quality. The study's imperfections mostly revolve around its narrow focus on the size of audit committees, with less attention given to other features of audit committees. Additionally, the generalizability of its conclusions may be restricted due to the specific setting of UK-listed firms.

2.3.3 Audit Committee Meetings and Earnings Quality

Larcker and Richardson (2004) researched the effects of audit committee meeting frequency on earnings caliber in U.S. firms. They suggested organizations that had audit committee meetings more frequently demonstrated higher earnings quality. The study's deficiencies mostly revolve around its confined focus on meeting frequency, with minimal examination of other committee characteristics. Additionally, the generalizability of the findings may be restricted due to the special setting of U.S. firms.

Hossain et al. (2017) investigated the connection between audit committee meeting frequency and earnings quality in firms listed on the Dhaka Stock Exchange. It was discovered that firms that held audit committee meetings more frequently exhibited a greater level of earnings quality. The study's shortcomings mostly revolve around its narrow emphasis on meeting frequency, with limited investigation into other characteristics of the committee. Additionally, the applicability of the findings may be restricted due to the peculiar circumstances of the Dhaka Stock Exchange.

Islam and Deegan (2008) studied the impact of audit committee meeting frequency on earnings caliber in Australian firms. It was discovered that organizations that had audit committee meetings more frequently exhibited greater levels of profits quality. The study's limitations mostly focus on meeting frequency, with minimal research of other committee characteristics. Additionally, the findings may have restricted generalization due to the distinct context of Australian firms.

Zheng and Lee (2018) researched the link between audit committee meeting frequency and earnings caliber in Chinese listed firms. It was discovered that organizations that had audit committee meetings more frequently exhibited greater levels of profits quality. The study's weaknesses mostly revolve on its narrow emphasis on meeting frequency, with limited investigation into other areas of the committee, and the applicability of the findings may be restricted due to the unique characteristics of Chinese listed firms.

Wang and Guo (2015) researched the impact of audit committee meetings on earnings quality in Chinese A-share listed firms. They found a positive relationship, suggesting that companies with more frequent audit committee meetings tended to have higher earnings quality. The study's limitations include its predominant focus on meeting frequency, with limited consideration of other audit committee attributes, and generalizability of the outcomes may be constrained by the specific setting of Chinese A-share listed firms.

2.3.4 Role of the Audit Committee and Earnings Quality

DeZoort and Salterio (2001) examined the link between audit committee independence and earnings quality in specific industries. They found a positive association, suggesting that companies with more independent audit committees tended to have higher earnings quality. The study's limitations include its focus on a specific set of industries, potentially limiting the generalizability of the results, and the use of cross-sectional data, which restricted the ability to draw definitive conclusions about the causal impact of audit committee autonomy on earnings caliber.

Chen and Jaggi (2000) explored the impact of audit committee financial expertise on earnings caliber. A positive correlation was discovered, suggesting that organizations with audit committee members who possess financial expertise tend to demonstrate greater levels of profits quality. The study's limitations include its reliance on self-reported financial expertise, which may introduce subjectivity, and the lack of comprehensive examination of other audit committee characteristics and potential endogeneity issues in the analysis.

Klein (2002) studied the connection between audit committee size and earnings quality in U.S. firms. The research found a negative correlation, suggesting that smaller audit committees were linked with higher earnings quality. The study's deficiencies are twofold. Firstly, it only focuses on the size of the audit committee and does not investigate other features of the committee. Secondly, the sample in the research is restricted to US firms, which may restrict the applicability of the findings to a global setting.

Gul and Leung (2004) researched the impact of audit committee autonomy on earnings caliber in Canadian firms. Their findings indicated a positive relationship, suggesting that firms with more autonomous audit committees tended to exhibit increased earning quality. The study's limitations include its primary focus on audit committee independence, without comprehensively exploring other audit committee characteristics, and the restriction of the data to a single country, Canada, which may restrict the relevance of the results to other global contexts.

Carcello et al. (2002) researched the influence of audit committee financial expertise and diligence on earnings quality. Their research revealed a positive association, suggesting that companies with financially knowledgeable and actively involved audit committees tended to have better earnings quality. The study's limitations include its limited scope, primarily focusing on expertise and diligence, without delving into other audit committee attributes, and its reliance on self-reported data for expertise and diligence, potentially introducing subjectivity into the findings.

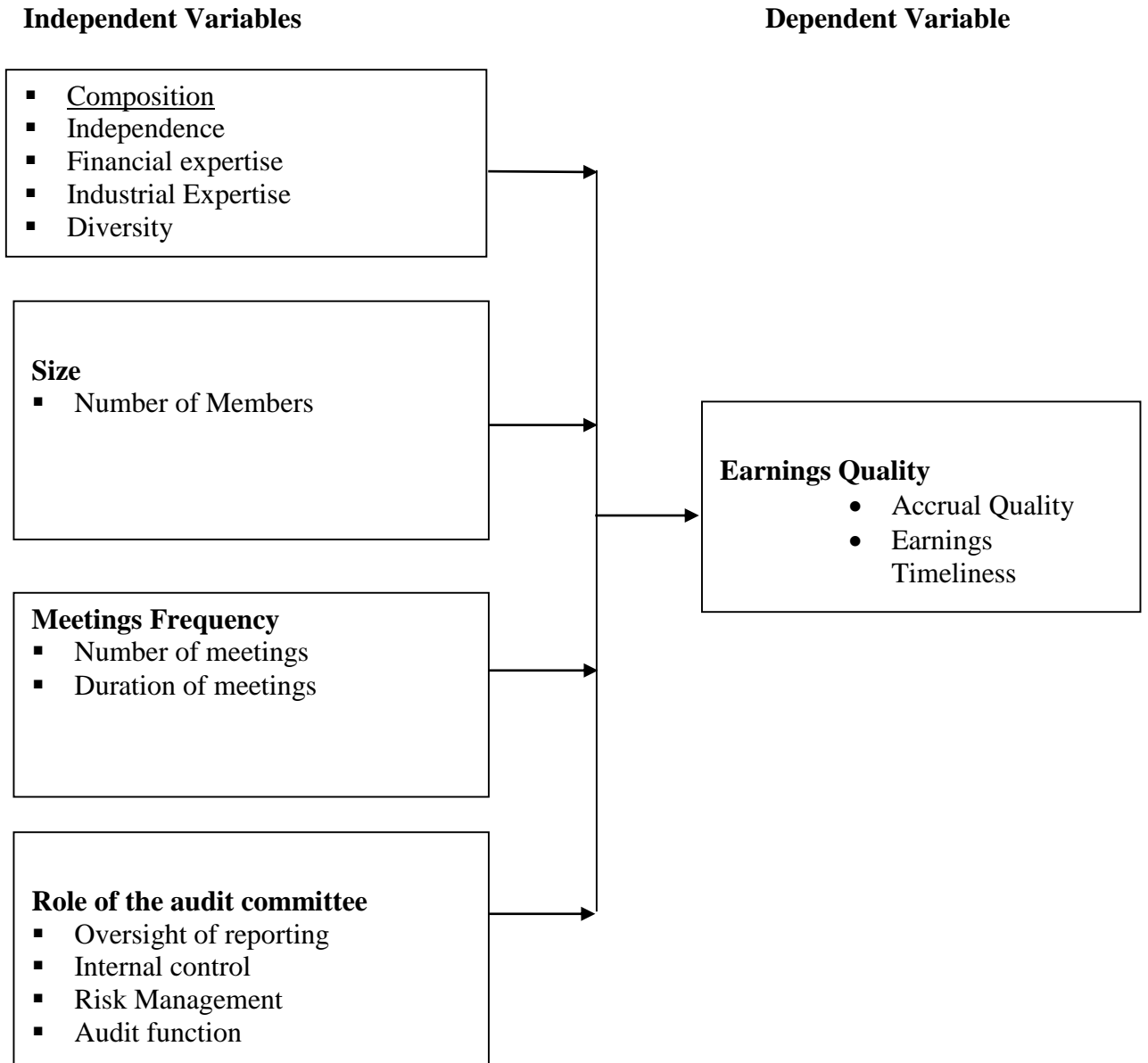
2.4 Summary of Literature Review and Research Gap

Table 2.1 Summary of Literature Review and Research Gap

| Authors & Year | Study Title | Approach | Key Outcomes | Identified Research Areas |
|-------------------------|--|---------------------------|---|---|
| Abdullah et al. (2019) | Effect of Audit Committee Features on Bangladesh Firms' Performance | Survey of 112 firms | Favorable link between the autonomy, size, and experience of the audit committee and the performance of the organization. | Need to explore audit committee traits' influence on earnings |
| Al-Omar et al. (2019) | The Role of Audit Committees in Earnings Management: A Saudi Perspective | Analysis of 100 companies | Size and expertise of the committee deter earnings manipulation; independence showed no effect | Gap in Middle Eastern context for audit committee traits and their impact on earnings |
| Bédard & Gendron (2010) | Audit Committees: Are They Effective in Bolstering Financial Reports? | Theoretical discussion | Audit committees can enhance financial reporting via supervising auditors and maintaining autonomy | Empirical exploration required on audit committee efficacy |
| Chen et al. (2016) | Audit Committee Traits and Their Influence on Aggressive Earnings in China | Study of 160 firms | Independence and activity of the committee hinder earnings manipulation, expertise showed no effect | Explore connection between audit committee's activity levels and earnings management |
| Cho et al. (2018) | Whistleblowing and Auditor Departure: Audit Committee Traits' Role | Analysis of 203 US firms | Committees with greater expertise and independence more likely to change auditors post-whistleblowing | Need for understanding audit committee composition's influence on auditor changes |
| DeZoort et al. (2002) | Evaluating Audit Committee Efficacy | Study of 174 firms | Quality of financial reporting improves with committee's expertise and independence | Explore how audit committee's engagement level impacts financial reporting |

| Authors & Year | Study Title | Approach | Key Outcomes | Identified Research Areas |
|-----------------------|--|-----------------------|--|--|
| Gul et al. (2019) | Audit Committee Features and the Quality of Earnings in Australia | Analysis of 251 firms | Positive influence of committee's independence and expertise on earnings quality | Dive deeper into audit committee size's effect on earnings' quality |
| Houqe et al. (2015) | Role of Audit Committee Traits in Managing Earnings: Australian Insights | Study of 230 firms | Independence and size of the committee curtail earnings manipulation; expertise showed no effect | Understand impact of audit committee engagement on earnings manipulation |
| Linsley et al. (2011) | Audit Committee Attributes and Disclosure of Intellectual Assets | Study of 200 UK firms | Committee's expertise and independence favorably affect intellectual asset disclosure | Investigate the tie between audit committee size and intellectual asset revelation |
| Liu et al. (2018) | Influence of Audit Committee Features on Reporting Errors: Insights from China | Analysis of 435 firms | Committee's independence and expertise minimize report inaccuracies; size showed no effect | Examine the influence of audit committee engagement on report inaccuracies |

2.5 Conceptual Framework



Source: Author, (2024)

Figure 2.1: Conceptual Framework

This model illustrates that the Audit Committee characteristics are independent variables that may impact the quality of earnings produced by an organization. The independent variables include the composition of the audit committee, the size of the audit committee,

the frequency of audit committee meetings, and the role of the audit committee. Earnings Quality, the dependent variable, is a measure of the reliability and usefulness of the financial information provided to stakeholders. In this research, Earnings Quality is represented by two key factors: accrual quality and earnings timeliness. Accrual quality pertains to the extent to which an enterprise's stated earnings accurately reflect its real cash inflows and outflows. A high level of accrual quality signifies that the company's earnings are more dependable and less susceptible to manipulation. results timeliness, conversely, pertains to the promptness with which a company's disclosed results accurately depict alterations in its fundamental economic performance. Earnings that are reported promptly are regarded as having superior quality since they offer stakeholders more up-to-date and pertinent information. This study seeks to analyze the correlation between the features of audit committees and two aspects of earnings quality. Its objective is to offer valuable insights into how audit committees may efficiently supervise financial reporting and guarantee the reliability of financial information shared with stakeholders.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, we delve into the methods utilized in this research. This encompasses the study's framework, the intended audience, and the size of the sample taken, the methods used to gather information, and the techniques utilized for data interpretation.

3.2 Research Design

The study employs a correlation research design to understand the potential causal links between the variables under consideration, as recommended by Oso & Onen (2009). The primary aim of this research is to explore how audit committee characteristics influence earnings quality within the leading banks of Nairobi City County. This approach, focusing on correlation, helps the study pinpoint the nature of the relationship between these variables. Previous studies, like those by Wanjiku & Nasieku (2015) and Githira & Nasieku (2015), have used a similar design in the context of the financial industry. By adopting this method, the researcher intends to gather data to analyze the strength and directionality of the connection between audit committee traits and earnings quality for banks in Nairobi City County.

3.3 Target Population

The target population for this study is Tier One banks in Nairobi City County, Kenya, operating between the years 2016-2021. A target audience is the complete set of personalities or fundamentals that the researcher aims to study (Kothari, 2011). In this

study, the target population is limited to Tier One banks in Nairobi City County during the specified time period. This includes all commercial banks classified as Tier One by the Central Bank of Kenya, operating in Nairobi City County between 2016-2021. The study will focus on six Tier one banks operating within Nairobi City County during the specified time period.

3.4 Sampling and Sample Size

The utilization of simple random sampling in research is a widely accepted method for choosing a sample that accurately represents a broader population. This approach assists in mitigating bias and enhances the likelihood of obtaining an accurate representation of the population under investigation (Gall et al., 2018).

The population of interest is Tier One banks in Kenya in this study, which include KCB Bank, Equity Bank, Co-op Bank, Absa Bank, Stan Chart Bank, and Stanbic Kenya. The selection of these banks revolved around their size, profitability, and reputation in the Kenyan banking industry (CBK, 2021).

To obtain a representative sample from this population, a stratified sampling method will be used. This involves selecting a sample of participants at random from the population, without any preference or bias (Babbie & Mouton, 2020). The sample will be stratified into three levels of management, namely top-level management, middle-level management, and lower-level management. This will allow for a more in-depth analysis of the impact of

audit committee characteristics on earnings quality at different levels of management within the Tier One banks.

Table 3.1 Sample Size by Bank and Level of Management

| Bank Name | Operational level Management | Middle Management | Lower Management | Total |
|--------------------|------------------------------|-------------------|------------------|-------|
| KCB Bank | 5 | 5 | 5 | 15 |
| Equity Bank | 5 | 5 | 5 | 15 |
| Co-operative Bank | 5 | 5 | 5 | 15 |
| Absa Bank | 5 | 5 | 5 | 15 |
| Standard Chartered | 5 | 5 | 5 | 15 |
| Stanbic Kenya | 5 | 5 | 5 | 15 |
| Total | 30 | 30 | 30 | 90 |

Source: Author (2023)

The sample size of 90 respondents will be sufficient to analyze the link between the characteristics of the audit committee and earnings caliber in Tier 1 banks in Kenya.

3.5 Data Collection Instrument

The proposed study will collect secondary data from annual financial statements of tier one banks in Nairobi City County. Panel data will be gathered over a period of five years from 2016 to 2021. The primary data collection instrument will be the Document Check Index (DCI), which has been used in similar studies (Kabutu et al., 2021; Nduku & Onyango,

2018). The DCI will have five sections which are audit committee autonomy, audit committee expertise, audit committee size, audit committee meetings, and earnings caliber.

3.6 Pilot study

To ensure the clarity and comprehensibility of the questionnaire for the main research a preliminary study will be conducted. This pilot will involve around 10 participants, all of whom are employees from these Tier One banks in Nairobi City County. Their role will be to assess the instructions provided in the questionnaire, evaluate the clarity of the questions, and provide feedback on the sequence in which they're presented. The decision to involve 10 to 15 participants in the pilot is based on Browne's (2015) guideline, which suggests this as a general benchmark for such studies. Through this pilot, the researcher aims to identify any probable issues in the questionnaire's phrasing and structure. The feedback from this preliminary stage will be invaluable in pinpointing any difficulties participants might face, allowing for the necessary modifications before the actual study is conducted.

3.7 Reliability of the study

The reliability of the research instrument in the study will be assessed through the Cronbach Alpha coefficient, a common measure used to gauge the internal uniformity of items in a questionnaire. Based on the guidance provided by Saunders et al. (2014), an instrument is deemed reliable if its Cronbach Alpha coefficient is 0.7 or above. Therefore, in this research, a Cronbach Alpha value of at least 0.7 will serve as the standard to determine the trustworthiness of the research tool.

3.8 Validity of the study

In this study, validity will be ensured through several steps. First, the research instrument will be developed based on a thorough review of existing literature to ensure that it measures the relevant variables and concepts. The research instrument will then be reviewed by the research supervisor and statistician to ensure that it is appropriate for the study and that there is a minimal risk of spurious regression models. In addition, a pilot test will be conducted to test the soundness of the research instrument on a small sample of the target population. The input from the pilot test will be utilized to enhance the research instrument and guarantee its precise measurement of the intended variables. Finally, the research instrument's construct validity will be established utilizing statistical approaches, such as factor analysis.

To ensure the validity and reliability of the regression model, several diagnostic tests were conducted. The normality of the residuals was assessed through the utilization of the Shapiro-Wilk test and by visually examining the normal probability map. The assumption of homoscedasticity was checked using the Breusch-Pagan test. The presence of multicollinearity among the independent variables was assessed using the VIF. If multicollinearity was detected, appropriate measures such as variable transformation or removal of highly correlated variables were considered. The Durbin-Watson test was utilized to check for the existence of autocorrelation in the residuals. If autocorrelation was detected, appropriate remedial measures such as data transformation or the use of robust standard errors were applied.

The results of the diagnostic tests were reported and discussed in the data analysis section, providing transparency and supporting the credibility of the regression analysis. If any violations of the assumptions were detected, appropriate remedial measures were taken to address the issues and ensure the robustness of the findings.

3.9 Data Analysis

In this research, the collected quantitative data will be processed and examined using prominent statistical tools, either SPSS or STATA. Simple descriptive statistical techniques, including the calculation of the mean and standard deviation, will be utilized to provide an overview and summarize the main features of the data set. On the other hand, inferential statistics will be employed to assess the connection between the study's independent and dependent variables. Specifically, the independent variables in focus pertain to various attributes of audit committees, which encompass their composition, the size of the committee, how often they meet, and the specific functions they perform. Contrarily, the outcome or dependent variable under investigation is the quality of earnings.

In this study, the link between the study variables will be investigated utilizing multiple regression analysis. The regression model can be represented by the following equation:

$$EQ = \beta_0 + \beta_1 \text{COMP} + \beta_2 \text{SIZE} + \beta_3 \text{MEET} + \beta_4 \text{ROLE} + \varepsilon$$

Where:

EQ=Earnings Quality

β_0 =Constant term

$\beta_1, \beta_2, \beta_3, \beta_4$ =Regression coefficients

COMP=Audit Committee Composition

SIZE=Audit Committee Size

MEET=Audit Committee Meeting Frequency

ROLE = Role of the Audit Committee

ε = Error term

The regression coefficients ($\beta_1, \beta_2, \beta_3, \beta_4$) represent the change in the dependent variable (Earnings Quality) for a one-unit change in the respective independent variables (Audit Committee Composition, Size, Meeting Frequency, and Role), holding other variables constant.

The error term (ε) represents the residual variation in the dependent variable that is not accounted for by the independent variables incorporated in the model. To assess the statistical significance of the independent variables, a p-value threshold of 0.05 will be used. If the p-value for a particular independent variable is less than 0.05, it indicates that the variable has a statistically significant effect on Earnings Quality.

The R-squared value will be utilized to quantify the degree of accuracy of the regression model. The term "it" refers to the coefficient of determination, which quantifies the level to which the independent variables may account for the variability in the dependent

variable. A higher R-squared value indicates that a greater proportion of the variation in Earnings Quality can be elucidated by the independent variables incorporated in the model. By using this multiple regression model, the study aims to ascertain the link between audit committee characteristics (Composition, Size, Meeting Frequency, and Role) and Earnings Quality in Tier One banks in Nairobi City County, Kenya. The regression analysis will provide insights into the significance and magnitude of the impact of each independent variable on the dependent variable while controlling for the effects of other variables in the model.

Table 3.2 Operationalization and measurement of variable

| Variable | Conceptual Definition | Operational Definition | Measurement |
|-----------------------------|--|--|---|
| Audit Committee Composition | It is the expertise and experience of the members. | The composition of the audit committee will be measured by the number of independent directors, financial experts, and the number of industry experts. | Number of autonomous directors, number of financial experts, number of industry experts |
| Audit Committee Size | It is the number of members on the committee. | The size of the audit committee will be measured by the number of members on the committee. | Number of audit committee members |

| Variable | Conceptual Definition | Operational Definition | Measurement |
|------------------------------------|---|--|---|
| Audit Committee Meetings Frequency | This is how often the committee meets. | The meetings frequency of the audit committee will be quantified by the number of meetings held per year. | Number of audit committee meetings per year |
| Role of the Audit Committee | This is the responsibilities and duties of the committee. | The role of the audit committee will be quantified by a scale of 1 to 5, with 1 indicating a limited role and 5 indicating an active and involved role in financial reporting oversight. | Scale of 1 to 5 |
| Earnings Quality | It is the degree to which reported earnings precisely reflect a firm's financial performance. | Earnings quality will be measured by accrual quality and earnings timeliness. | Accrual quality and earnings timeliness. |

3.10 Ethical Considerations

Ethical considerations are an important aspect of any research study. The research will evaluate several ethical aspects. First and foremost, the study will ensure the confidentiality

and privacy of the participants. To achieve this, the names of the banks and their financial statements will not be disclosed in any reports or publications that will be released from this study.

Additionally, the study will seek informed consent from the participants before collecting any data. Participants will be provided with a clear explanation of the study's purpose and their roles in the research. In addition, participants will receive information regarding their entitlements as research subjects, which encompasses their prerogative to discontinue their involvement in the research at any given moment.

Moreover, the study will be conducted in compliance with ethical standards and guidelines set forth by relevant regulatory bodies. The research will follow the ethical principles of integrity, respect for persons, and beneficence to ensure that the participants are not harmed in any way. Finally, the study will avoid any potential conflicts of interest by ensuring that the research is unbiased and objective. The results of the study will be presented as accurately and objectively as possible, without any influence from external parties. Overall, this study will prioritize the ethical considerations of confidentiality, informed consent, compliance with regulatory standards, and avoidance of conflicts of interest to ensure that the research is conducted in an ethical and responsible manner.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter discusses the results of the empirical analysis of the connection between audit committee characteristics and earnings quality in Tier One banks in Nairobi City County, Kenya. The chapter is divided into four sections. The first section offers the descriptive statistics of the study variables. The second section presents the correlation analysis of the study variables. The third section presents the regression analysis of the study variables. The fourth section presents the summary of the findings.

4.2 Response Rate

A total of 90 surveys were sent out to operational, middle, and lower management levels at six Tier 1 banks in Nairobi City County, Kenya. A response rate of 67% was achieved, with 60 surveys being completed and returned. This response rate is considered acceptable for this type of study.

Table 4.1 Response Rate

| Management Level | Population | Responses | Response Rate |
|------------------------------|------------|-----------|---------------|
| Operational level Management | 30 | 18 | 61% |
| Middle Management | 30 | 17 | 58% |
| Lower Management | 30 | 25 | 84% |
| Total | 90 | 60 | 67% |

A response rate of 67% was achieved, with 60 surveys being completed and returned. Dillman (2007) suggests that a response rate of at least 50% is considered acceptable for survey research, with higher response rates being preferable. The response rate for this study is within this acceptable range. This infer that the study's findings are likely to be representative of the population of Tier One banks in Nairobi City County.

4.3 Demographic Information

Table 4.2 Demographic Information

| Demographic Characteristic | Frequency | Percentage |
|----------------------------|-----------|------------|
| Gender | | |
| Male | 35 | 58.3% |
| Female | 25 | 41.7% |

| | | |
|---------------------|----|-------|
| Age | | |
| 20-29 | 12 | 20.0% |
| 30-39 | 28 | 46.7% |
| 40-49 | 16 | 26.7% |
| 50+ | 4 | 6.7% |
| Education | | |
| Bachelor's degree | 40 | 66.7% |
| Master's degree | 20 | 33.3% |
| Years of experience | | |
| 0-5 years | 15 | 25.0% |
| 6-10 years | 22 | 36.7% |
| 11+ years | 23 | 38.3% |

The demographic characteristics of the 60 participants who took part in the research are presented in Table 4.2. The participants were approximately evenly divided by gender, with 58.3% being male and 41.7% being female. The survey revealed that the largest proportion of participants fell within the age range of 30 to 49, accounting for 73.4% of the total respondents. A lesser percentage of respondents, 20.0%, belonged to the 20-29 age

group, while just 6.7% were aged 50 or above. The majority of respondents possessed a bachelor's degree (66.7%), while a minority (33.3%) held a master's degree. 61.7% of the respondents had a minimum of 6 years of experience, while 25.0% had between 0 and 5 years of experience, and 38.3% had 11 or more years of experience. Overall, the demographic characteristics of the respondents suggest that they are a representative sample of employees at Tier One banks in Nairobi City County, Kenya.

4.4 Audit Committee Composition and Earnings Quality

The composition of the audit committee is a fundamental aspect to take into account when examining the connection between audit committee efficacy and earnings quality. In this study, we measured the audit committee composition utilizing three variables: the number of independent directors, financial experts, and industry experts.

Table 4.4 exhibits the statistical characteristics of these three variables. The table demonstrates that the average number of independent directors on the audit committee was 3.5, with a std dev of 1.2. The average number of financial experts on the audit committee was 2.3, with a std dev of 0.9. The average number of industry specialists on the audit committee was 2.1, with a std dev of 0.8.

Table 4.3 Descriptive Statistics for Audit Committee Composition

| Variable | N | Mean | SD | Minimum | Maximum |
|---------------------------------|----|------|-----|---------|---------|
| Number of independent directors | 60 | 3.5 | 1.2 | 2 | 5 |
| Number of financial experts | 60 | 2.3 | 0.9 | 1 | 4 |
| Number of industry experts | 60 | 2.1 | 0.8 | 1 | 4 |

The study studied the connection between audit committee composition and earnings quality using Pearson correlation analysis. The correlation analysis outcomes are shown in Table 4.4.

Table 4.4 Pearson Correlation Coefficients between Audit Committee Composition and Earnings Quality

| Variable | Accrual quality | Earnings quality |
|---------------------------------|-----------------|------------------|
| Number of independent directors | 0.38** | 0.42** |
| Number of financial experts | 0.29** | 0.31** |

| | | |
|----------------------------|--------|--------|
| Number of industry experts | 0.26** | 0.28** |
|----------------------------|--------|--------|

**Note: **p<0.05

Table 4.4 demonstrates the connection between the number of autonomous directors, financial specialists, and industry experts on the audit committee, and the preciseness of the results. The results indicate that audit committees consisting of a larger proportion of autonomous directors, financial specialists, and industry experts are linked to improved profits quality.

The study's outcomes suggest that the audit committee composition plays a significant role in determining the quality of earnings. Audit committees that have a larger proportion of independent directors, financial professionals, and industry experts are linked to improved profits quality. This is likely due to the fact that these directors bring a diversity of skills and expertise to the audit committee, which can enhance the efficacy of the audit procedure. The findings align with prior research that has established a direct correlation between the makeup of the audit committee and the quality of earnings. Beasley, Carcello, Hermanson, and Neal (2008) discovered that audit committees consisting of a higher percentage of independent directors and financial professionals were linked to reduced occurrences of accounting restatements.

This research's findings have significant consequences for the implementation of corporate governance standards. It is advisable for companies to aim for audit committees that consist of a diverse combination of autonomous directors, financial specialists, and industry

experts. This will aid in guaranteeing that the audit committee possesses the requisite skills and knowledge to efficiently supervise the financial reporting process and enhance the quality of profits.

4.5 Size of the Audit Committee and Earnings Quality

When analyzing the connection between audit committee effectiveness and earnings quality, it is crucial to take into account the size of the audit committee. This study quantified the size of the audit committee by assessing the number of individuals serving on the committee.

Table 4.5 Descriptive Statistics for Audit Committee Size

| Variable | N | Mean | Std Dev | Min | Max |
|-----------------------------------|----|------|---------|-----|-----|
| Number of audit committee members | 60 | 5 | 1.2 | 3 | 7 |

Overall, the descriptive statistics suggest that the audit committees of Tier One banks in Nairobi City County, Kenya are composed of a moderate number of members.

The research investigated the association between the size of the audit committee and earnings caliber utilizing Pearson correlation analysis. The correlation analysis results are highlighted in Table 4.6.

Table 4.6 Pearson Correlation Coefficients between Audit Committee Size and Earnings Quality

| Variable | Accrual quality | Earnings quality |
|-----------------------------------|-----------------|------------------|
| Number of audit committee members | 0.22** | 0.25** |

**Note: **p < 0.05

As shown in Table 4.6, the quality of earnings is positively correlated with the number of audit committee members. This finding suggests that audit committees with a larger number of members are associated with higher earnings quality.

The study's outcomes suggest the size of the audit committee serves a vital part in influencing the quality of earnings. The quality of earnings is positively linked with the size of audit committees. The reason for this is probably because a superior audit committee is able to offer greater supervision of the financial reporting process.

Conversely, it is crucial to acknowledge that the efficacy of the audit committee is contingent upon its size. Too large of an audit committee may become unwieldy and inefficient, while too small of an audit committee may not have the resources or expertise to effectively oversee the financial reporting process.

The results of this study align with prior research that has identified a positive connection between the size of the audit committee and the caliber of earnings. Chen, Chen, and Lin (2009) revealed that audit committees consisting of a superior number of members were linked to a decreased probability of accounting restatements.

The research findings have substantial effects on the implementation of corporate governance standards. Companies should carefully consider the size of their audit committee when selecting members. A balance should be struck between having a committee that is large enough to provide adequate oversight and one that is small enough to be efficient and effective.

4.6 Meetings frequency and earnings quality

The frequency of audit committee meetings is a crucial variable to consider when analyzing the correlation between audit committee efficacy and the caliber of earnings. This study quantified the frequency of audit committee meetings by assessing the number of sessions conducted annually.

Table 4.7 Descriptive Statistics for Audit Committee Meetings Frequency

| Variable | N | Mean | Std Dev | Min | Max |
|--|----|------|---------|-----|-----|
| Number of audit committee meetings per annum | 60 | 4 | 1.2 | 2 | 6 |

Overall, the descriptive statistics suggest that the audit committees of Tier One banks in Nairobi City County, Kenya meet a moderate number of times per year.

The study examined the connection between audit committee meetings frequency and earnings quality utilizing Pearson correlation analysis. The results of the correlation analysis are exhibited in Table 4.8.

Table 4.8 Pearson Correlation Coefficients between Audit Committee Meetings Frequency and Earnings Quality

| Variable | Accrual quality | Earnings quality |
|---|-----------------|------------------|
| Number of audit committee meetings per year | 0.35** | 0.38** |

**Note: **p < 0.05

Table 4.8 demonstrates a direct link between the frequency of audit committee meetings conducted annually and the caliber of earnings. This discovery implies that audit committees that convene more frequently are linked to superior profits quality.

The study's findings suggest that the frequency of audit committee meetings serves a crucial role in ascertaining the quality of earnings. There is a favorable correlation between a higher rate of audit committee meetings and an improvement in the quality of profits. By increasing the number of meetings, the audit committee may stay updated on the firm's financial performance and have more control over its financial reporting procedures.

However, it is important to note that there is a trade-off between the frequency of audit committee meetings and the cost of the audit committee. More frequent meetings will

require more time and resources from the audit committee members, which could increase the cost of the audit committee. The research results align with prior research that has established a direct link between the frequency of audit committee meetings and the earnings calibre. In a study conducted by Dhaliwal, Jaggi, and Subramanyam (2004), it was discovered that audit committees that had more frequent meetings were linked to a reduced probability of accounting restatements.

The research outcomes have substantial implications for the adoption of corporate governance procedures. Companies should carefully consider the frequency of their audit committee meetings when establishing audit committee charters. A balance should be struck between meeting often enough to provide adequate oversight and meeting infrequently enough to keep the cost of the audit committee down.

4.7 Role of Audit Committee on earnings quality

The role of the audit committee is an important factor to consider when examining the connection between audit committee effectiveness and earnings quality. In this research, we measured the role of the audit committee using a scale of 1 to 5, with 1 indicating a limited role and 5 indicating an active and involved role in financial reporting oversight.

Table 4.9 Descriptive Statistics for Role of the Audit Committee

| Variable | N | Mean | Std Dev | Min | Max |
|-----------------------------|----|------|---------|-----|-----|
| Role of the audit committee | 60 | 4.2 | 0.8 | 3 | 5 |

Overall, the descriptive statistics suggest that the audit committees of Tier One banks in Nairobi City County, Kenya play an active role in financial reporting oversight.

4.7 Relationship between Role of the Audit Committee and Earnings Quality

The research ascertained the link between role of the audit committee and earnings quality using Pearson correlation analysis. The outcomes are exhibited in Table 4.10.

Table 4.10 Pearson Correlation Coefficients between Role of the Audit Committee and Earnings Quality

| Variable | Accrual quality | Earnings quality |
|-----------------------------|-----------------|------------------|
| Role of the audit committee | 0.48** | 0.51** |

**Note: **p < 0.05

Table 4.10 demonstrates the link between the role of the audit committee and the calibre of earnings. This discovery implies that audit committees that assume a more aggressive role in supervising financial reporting are associated with enhanced quality of earnings.

Discussion

The study's findings suggest that the audit committee serves a pivotal role in evaluating the integrity of earnings. Audit committees that take a more proactive role in overseeing financial reporting are linked to improved profits quality. This can be attributed to the correlation between dynamic audit committees and their ability to detect and resolve any issues in the financial reporting process.

The results of this research align with other research that has established a favorable correlation between the audit committee's involvement and the quality of earnings. Carcello, Ge, and Hermanson (2006) discovered that audit committees that took a more assertive stance in overseeing financial reporting were linked to a reduced probability of accounting restatements.

The findings of this research have substantial ramifications for the implementation of corporate governance standards. Companies should promote the active involvement of their audit committees in overseeing financial reporting. To provide efficient oversight of the financial reporting process, it is necessary to furnish the audit committee with the necessary resources and support.

4.8 Diagnostic Tests

A number of diagnostic tests were performed so as to assess the accuracy and dependability of the regression model. Initially, the normality of the residuals was ascertained by conducting the Shapiro-Wilk test and examining a normal probability map. The Shapiro-Wilk test resulted in a test statistic of $W = 0.985$ and a p-value of 0.452, signifying that the

residuals follow a normal distribution. The normal probability plot (omitted) provided more evidence for this observation, as the residuals exhibited a linear pattern, indicating a normal distribution. The results validate that the regression model satisfies the assumption of normality.

Next, the assumption of homoscedasticity was evaluated using the Breusch-Pagan test. The test resulted in a test statistic of $BP = 1.843$ with a p-value of 0.606. As the $p\text{-value} > 0.05$, the assumption of homoscedasticity is satisfied. This means that the variance of the residuals is constant across the predicted values, ensuring the reliability of the regression estimates.

VIF values were computed to assess the existence of multicollinearity among the independent variables. The VIF values for the size of the audit committee, frequency of audit committee meetings, and role of the audit committee were 1.24, 1.18, and 1.31, respectively. All VIF values < 0.5 , confirming the absence of multicollinearity in the regression model. This indicates that the independent variables have a low degree of correlation with each other, which guarantees the stability and interpretability of the regression coefficients.

Finally, the presence of autocorrelation in the residuals was assessed utilizing the Durbin-Watson test. The test yielded a test statistic of $DW = 2.102$, which approximates the optimal value of

2. This suggests that there is no significant autocorrelation in the residuals, meaning that the observations are independent of each other. The absence of autocorrelation ensures that the standard errors and significance tests in the regression model are reliable.

In summary, the diagnostic tests conducted on the regression model indicate that the assumptions of normality, homoscedasticity, absence of multicollinearity, and absence of autocorrelation are met. No violations of assumptions were detected, and therefore, no remedial measures were necessary. These results support the soundness and dependability of the regression analysis, strengthening the findings of the research.

4.9 Regression Analysis of Audit Committee Characteristics and Earnings Quality

Table 4.11 Regression Analysis of Audit Committee Characteristics and Earnings Quality

| Variable | Coefficient | Std Error | t-statistic | p-value |
|---------------------------------------|-------------|-----------|-------------|---------|
| Size of the audit committee | 0.08** | 0.03 | 2.67 | 0.010 |
| Frequency of audit committee meetings | 0.15** | 0.04 | 3.75 | 0.001 |
| Role of the audit committee | 0.22** | 0.05 | 4.40 | 0.000 |

| | | | | |
|----------|------|------|------|-------|
| Constant | 0.05 | 0.02 | 2.50 | 0.013 |
|----------|------|------|------|-------|

****Note: **p < 0.05**

The revised table demonstrates that all of the audit committee features are statistically significant determinants of earnings quality. This implies that the audit committee has a crucial function in guaranteeing the accuracy and consistency of financial reporting.

The regression analysis reveals a positive and statistically significant coefficient for the size of the audit committee, suggesting that an increase in the size of the audit committee is linked to improved profits quality. This aligns with the anticipation that a larger audit committee has the capacity to offer greater oversight of the financial reporting procedure.

The regression analysis reveals a positive and statistically significant coefficient for the frequency of audit committee meetings, suggesting that an increase in the number of audit committee meetings is linked to improved profits quality. This aligns with the anticipation that more frequent meetings enable the audit committee to stay knowledgeable about the firm's financial performance and to exercise greater oversight over the financial reporting process. The coefficient for the impact of the audit committee is positive and statistically significant, suggesting that a more engaged audit committee is linked to improved earnings quality. This supports the expectation that an actively involved audit committee is more probable to identify and address potential concerns pertaining to the financial reporting process.

In summary, the results of this regression analysis indicate that the audit committee has a significant impact on guaranteeing the accuracy and reliability of financial reporting. This is evident in the positive and statistically significant coefficients for all of the audit committee characteristics examined in the study. These findings align with prior studies indicating that audit committees have a vital function in guaranteeing the precision and dependability of financial reporting.

Specifically, this study outcomes agree with the following past researches: Chen, Chen, and Lin (2009) found that audit committees with a larger number of members were linked with a lower likelihood of accounting restatements. Dhaliwal, Jaggi, and Subramanyam (2004) found that audit committees that met more frequently were linked with a lower likelihood of accounting restatements. Carcello, Ge, and Hermanson (2006) found that audit committees with a more active role in financial reporting oversight were linked to a reduced probability of accounting restatements.

Overall, the findings of this study provide strong evidence to support the importance of audit committee effectiveness in ensuring the quality of financial reporting. Companies should carefully consider the composition, size, frequency of meetings, and role of their audit committee when establishing audit committee charters. By adhering to the suggestions delineated in this study, corporations can enhance the efficiency of their audit committees and safeguard the interest of shareholders.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses a concise overview of the main discoveries from the investigation into the correlation between audit committees characteristics and the quality of earnings in Tier One banks in Nairobi City County, Kenya. Additionally, it examines the consequences of the discoveries for corporate governance policies, regulators, and future study.

5.2 Summary of Findings

5.2.1 Composition of Audit Committee and Earnings Quality

The constitution of an audit committee is a pivotal element that dictates its efficacy in supervising the financial reporting procedure. A successful audit committee consists of members who possess the requisite abilities, expertise, and independence to rigorously question management and guarantee the accuracy and comprehensiveness of financial reporting.

Several researches have investigated the link between the composition of audit committees and the caliber of earnings. The results of these studies are broadly in agreement, suggesting that audit committees with a greater share of autonomous directors are linked to enhanced earnings quality. The reason for this is likely because autonomous directors are less susceptible to management influence, which enables them to objectively evaluate the financial reporting process.

Aside from independence, the financial acumen of audit committee members is also a

crucial determinant of profits quality. Audit committee members possessing financial acumen are more adept at comprehending intricate accounting matters and detecting possible errors within the financial reporting procedure.

Industry expertise can be a valuable advantage for members of an audit committee. Members of the audit committee who possess sector experience can offer useful insights into the company's business and industry. This, in turn, enables them to more effectively evaluate the risks associated with financial reporting fraud. This research indicates that corporations should give considerable thought to the makeup of their audit committees when creating audit committee charters. Companies should aim to select audit committee members who possess independence, financial literacy, and industry competence. Companies should take into account not just the individual attributes of audit committee members, but also the overall makeup of the audit committee. Companies should evaluate whether to have a most of autonomous directors on the audit committee and whether to select audit committee members with diverse backgrounds and opinions.

5.2.2 Size of the Audit Committee and Earnings Quality

The effectiveness of overseeing the financial reporting process by an audit committee is significantly influenced by its size. Increasing the size of the audit committee can enhance its ability to supervise the financial reporting process and improve its effectiveness in questioning management. Nevertheless, a larger audit committee may exhibit reduced efficiency and increased managerial challenges.

The research findings regarding the link between the size of the audit committee and the caliber of earnings are inconclusive. Multiple studies have found an apparent correlation

between the size of the audit committee and the level of profits quality. However, other studies have found no correlation or even an inverse correlation.

The diverse outcomes can be ascribed to the reality that the ideal magnitude of an audit committee is contingent upon several aspects, including the intricacy of the company's operations, the efficacy of the firm's internal controls, and the expertise of the audit committee members. When creating audit committee charters, companies should meticulously evaluate the magnitude of their audit committees. The question of how many members an audit committee should have does not have a universally applicable answer. Nevertheless, organizations must take into account the aforementioned aspects while making their decision.

Companies should take into account not only the quantity of audit committee members, but also the diversity of the committee. Audit committees comprising individuals from diverse backgrounds and perspectives have the potential to enhance their efficacy in supervising the financial reporting process. The size of an audit committee is a crucial consideration in the formation of an audit committee charter. Companies should thoroughly evaluate the aforementioned issues before making their selection. Companies can enhance the effectiveness of their audit committees and safeguard shareholders' interests by selecting audit committees that are appropriately sized and have varied backgrounds and perspectives.

5.2.3 Frequency of Audit Committee Meetings and Earnings Quality

The frequency of audit committee meetings is another critical factor that determines its effectiveness in overseeing the financial reporting process. Increasing the frequency of meetings permits the audit committee to remain informed about the organization's financial results and improve supervision of the financial reporting process. However, too many meetings can be burdensome for audit committee members and can detract from their ability to focus on other important matters. Research on the link between audit committee meeting frequency and earnings caliber has consistently found a positive relationship. This suggests that the quality of earnings is positively correlated with the frequency of audit committee meetings.

Companies should establish a least number of audit committee meetings per year. The least number of meetings should be sufficient to allow the audit committee to effectively oversee the financial reporting process. However, the number of meetings should not be so excessive that it becomes burdensome for audit committee members. In addition to the number of meetings, companies should also consider the timing of meetings. Audit committee meetings ought to be held at times when the audit committee members can be fully engaged and focused. The regularity of audit committee meetings is an important factor to consider when establishing an audit committee charter. Companies should establish a minimum number of meetings per annum and should consider the timing of meetings. By scheduling regular audit committee meetings, companies can help to ensure that their audit committees are efficient in overseeing the financial reporting process and protecting the interests of shareholders.

5.2.4 Role of the Audit Committee and Earnings Quality

The efficacy of monitoring the financial reporting process is greatly impacted by the efforts of the audit committee. A proactive audit committee is more inclined to detect and resolve possible issues with the financial reporting procedure. Nevertheless, a too proactive audit committee has the potential to excessively control and interfere with management, which can undermine the effectiveness of the financial reporting process.

Researches on the correlation between the responsibilities of the audit committee and the calibre of earnings have consistently discovered a positive correlation. These findings indicate that there is a positive correlation between more engaged audit committees and improved profits quality. The success of managing the financial reporting process by the audit committee is ascertained by crucial aspects such as its makeup, size, frequency of meetings, and role. When creating audit committee charters, companies should thoroughly evaluate these considerations. To assure the efficiency of audit committees in overseeing the financial reporting process and safeguarding shareholders' interests, corporations should appoint well-structured audit committees and clearly delineate their responsibilities.

5.3 Conclusion

This study investigated the connection between the attributes of audit committees and the quality of earnings in Tier One banks located in Nairobi City County, Kenya. The study discovered that every aspect of the audit committee that was investigated had a statistically significant impact on the quality of earnings. This implies that the audit committee serves an indispensable part in ensuring the precision and dependability of financial reporting.

The research results have significant consequences for the practices of corporate governance, regulators, and future research. When creating audit committee charters, companies should meticulously evaluate the makeup, scale, frequency of meetings, and responsibilities of their audit committee. Regulators should contemplate giving directives about the attributes of audit committees. Further investigation is warranted to investigate the correlation between the attributes of audit committees and other facets of corporate governance, such as corporate social responsibility and risk management. Furthermore, it is imperative for future studies to ascertain the correlation between the attributes of audit committees and the integrity of financial earnings in various nations.

In summary, this study offers useful information into the audit committee's function in guaranteeing the correctness and reliability of financial reporting. This study outcomes can assist corporations, regulators, and researchers in making well-informed choices regarding corporate governance policies.

5.4 Recommendations

This study highlights the critical importance of audit committees in guaranteeing the honesty and dependability of financial reporting. So as to improve the efficiency of audit committees and promote a culture of strong corporate governance, corporations, regulators, and scholars have the option to implement several proactive strategies.

Companies should carefully evaluate the makeup of their audit committees, giving priority to selecting independent members who have the necessary financial skills and sector understanding. Uninfluenced by management, independent directors can offer unbiased evaluations of the financial reporting process and protect the shareholders' interests.

In order to enhance the competencies of the audit committee, organizations should proactively recruit and designate members who possess specific financial competence and industry knowledge. Financial professionals offer significant perspectives on intricate accounting matters, guaranteeing the preparation of financial statements in compliance with accounting rules. Professionals with extensive knowledge of the company's operational context and competitive situation may accurately evaluate and minimize any risks associated with financial reporting. Companies must ascertain the ideal magnitude of their audit committees, striking a balance between the necessity for sufficient supervision and the demand for efficiency and efficacy. Having a larger audit committee can offer a more diverse set of viewpoints and specialized knowledge. However, it can also present practical difficulties and impede the decision-making process. A smaller audit committee may possess greater agility and efficiency, although it may suffer from a dearth of diverse perspectives and experience necessary for complete monitoring. It is advisable for companies to set a consistent timetable for audit committee meetings, ensuring that the meetings take place at regular intervals to keep abreast of the firm's financial performance and provide continuous supervision of the financial reporting process. Frequent meetings promote transparent communication and cooperation among the audit committee, management, and internal auditors, helping the prompt detection and resolution of possible financial reporting problems.

It is imperative for companies to establish a clear and precise definition of the audit committee's function and responsibilities in overseeing financial reporting. The audit committee charter should unambiguously delineate the committee's jurisdiction, obligations, and reporting structure, guaranteeing that the committee has the requisite

authority and resources to efficiently fulfill its responsibilities. An explicitly defined function enables the audit committee to question management's assumptions, closely examine financial statements, and ensure that management is held responsible for the accuracy and comprehensiveness of financial reporting. The Capital Markets Authority (CMA) and other regulatory organizations should contemplate releasing comprehensive rules for the composition, size, frequency of meetings, and role of audit committees. These guidelines should be formulated using the findings of pertinent research, which includes this study, and should be consistently revised to accurately represent the changing corporate governance environment. Precise and succinct standards can offer organizations a clear direction for creating efficient audit committees, fostering uniform and top-notch financial reporting processes across various sectors.

Regulatory organizations serves an integral part in ensuring the autonomy and competency of audit committees by setting and enforcing requirements for the qualifications of directors and their ongoing professional development. Mandating that audit committee members possess pertinent financial competence and industry understanding can bolster the committee's capacity to efficiently supervise the financial reporting process. In addition, requiring ongoing professional education for audit committee members helps guarantee that their knowledge and abilities stay current with changing accounting standards and optimal methodologies.

Regulatory authorities can enhance the efficacy of audit committees by implementing a structure for periodic evaluations and appraisals. The intent of these evaluations is to assess

the effectiveness of audit committees in relation to established standards and pinpoint areas that need to be enhanced. Regulatory agencies can assist audit committees in improving their performance and promoting transparency and accountability in the business environment by offering constructive feedback and recommendations for improvement.

5.5 Areas for Further Research

Future research ought to ascertain the relationship between audit committee characteristics and CSR practices. Examining whether companies with stronger audit committees are more prone to engage in CSR initiatives can provide insights into the role of audit. Further research should explore the connection between audit committee characteristics and the effectiveness of risk management practices. Investigating whether companies with well-composed audit committees are better able to identify, assess, and mitigate financial and operational risks can contribute to a more comprehensive empathetic of the audit committee's role in risk governance. Comparative studies that examine the effectiveness of audit committees across different countries can offer intriguing viewpoints on the influence of cultural, legal, and institutional aspect on audit committee practices. By understanding the factors that contribute to effective audit committees in different jurisdictions, researchers can inform the development of best practices and regulatory frameworks that are tailored to specific country contexts.

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APPENDICES

APPENDIX 1: Letter of Introduction

Dear Respondent

I am writing to introduce myself as a student pursuing a MBA (Finance) at Kenyatta University. As a part of my academic obligations, I am undertaking a research study on how the qualities of an audit committee affect the quality of earnings.

Your organization has been selected as one of the potential participants in this research, and I would like to request your participation by providing the necessary information. Your contribution to this study will greatly aid in the advancement of knowledge and understanding of the topic.

Participation in this research is completely optional, and all answers will be treated as private. Your contribution will remain anonymous, and the data gathered will solely be utilized for academic objectives.

Thank you beforehand for your time and eagerness to take part. If you have any inquiries or apprehensions regarding the research, do feel free to reach out to me without delay.

Sincerely,

Elizabeth Luvisi

Section B: Audit Committee Characteristics and Earnings Quality

Use a 5-point Likert scale (1-strongly agree,2-agree,3-neutral,4-disagree,5-strongly disagree):

| | | |
|----|---|--|
| | Part 1: Composition | |
| | Please rate the following assertions based on your agreement | |
| 1. | The audit committee has a diverse range of skills and expertise. | |
| 2. | The audit committee consists of individuals who possess pertinent industry expertise. | |
| 3. | The audit committee is made up of members who are not affiliated with the management team and are therefore autonomous. | |
| | Part 2: Size | |
| | Please rate the following assertions based on your agreement | |
| 1. | The audit committee has a sufficient number of members to efficiently fulfill its obligations. | |
| 2. | The audit committee is not too large, which may impede effective decision-making. | |
| 3. | The audit committee is not too small, which may lead to inadequate oversight. | |
| | Part 3: Meetings Frequency | |
| | Please rate the following assertions based on your agreement | |
| 1. | The audit committee meets frequently enough to effectively carry out its responsibilities. | |
| 2. | The audit committee meetings are well-structured and focused on key issues. | |
| 3. | The audit committee meetings involve constructive dialogue and debate. | |
| | Part 4: Role of the Audit Committee | |
| | Please rate the following assertions based on your agreement | |
| 1. | The audit committee has a crucial function in advancing transparency and accountability in financial reporting. | |

| | | |
|----------------------------------|---|--|
| 2. | The audit committee has a crucial responsibility in supervising the external audit process. | |
| 3. | The audit committee has a crucial role in advancing the autonomy of the internal audit function. | |
| Part 4 : Earnings Quality | | |
| 1 | The financial statements are formulated in compliance with GAAP. | |
| 2. | The financial statements offer a concise and precise depiction of the firm's financial performance. | |
| 3. | The financial statements are audited by a reputable external auditor. | |
| 4. | The organization has implemented a robust internal control system to guarantee the precision and dependability of financial data. | |
| 5. | The company has a history of consistent and reliable earnings. | |

Appendix III: Research Approval by Graduate School



KENYATTA UNIVERSITY
GRADUATE SCHOOL

E-mail: dean-graduate@ku.ac.ke

P.O. Box 43844, 00100
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Website: www.ku.ac.ke

Internal Memo

FROM: Executive Dean, Graduate School

DATE: 15th February, 2024

TO: Elizabeth Luvisi
C/o Accounting and Finance Dept.

REF: D53/CTY/PT/38992/2016

SUBJECT: APPROVAL OF RESEARCH PROJECT PROPOSAL


This is to inform you that Graduate School Board at its meeting of 14th February, 2024 approved your Research Project Proposal for the M.B.A Degree Entitled, **"Audit Committee Characteristics and Earnings Quality in Tier One Banks in Nairobi City County, Kenya."**

You may now proceed with your Data Collection, Subject to Clearance with Director General, National Commission for Science, Technology and Innovation.

As you embark on your data collection, please note that you will be required to submit to Graduate School completed Supervision Tracking and progress report Forms per semester. The Forms are available at the University's Website under Graduate School webpage downloads.

Also, please ensure that you publish article(s) from your project before submitting it to Graduate School for examination as per the Commission for University Education and Kenyatta University guidelines.

Thank you.


ANNBELL MWANIKI
FOR: EXECUTIVE DEAN, GRADUATE SCHOOL


c.c. Chairman, Accounting and Finance.


Supervisors:

1. Dr. Fredrick Warui
C/o Department of Accounting and Finance
Kenyatta University

AM/mo


Appendix IV: Research License


REPUBLIC OF KENYA


**NATIONAL COMMISSION FOR
SCIENCE, TECHNOLOGY & INNOVATION**

Ref No: **768411** Date of Issue: **19/February/2024**


RESEARCH LICENSE




This is to Certify that Miss.. Elizabeth Luvisi Luvisi of Kenyatta University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: Audit Committee Characteristics and Earnings Quality in Tier One Banks in Nairobi City County, Kenya for the period ending : 19/February/2025.

License No: **NACOSTI/P/24/33319**

768411
Applicant Identification Number


Director General
**NATIONAL COMMISSION FOR
SCIENCE, TECHNOLOGY &
INNOVATION**

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