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EFFECTS OF AUDIT COMMITTEE CHARACTERISTICS ON QUALITY OF FINANCIAL REPORTING AMONG FIRMS LISTED IN NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract

The purpose of the study was to establish the effects of audit committee characteristics on quality of financial reporting among firms listed in Nairobi Securities Exchange, Kenya. The study was guided by the agency theory. Explanatory research design was used. A survey of all firms was done and only 46 firms were extracted because they were operating in NSE at the year 2014. This study utilized secondary data which was collected by use of a document analysis guide. Data collected was analyzed by using both descriptive and inferential statistical methods. The findings indicated that audit committee size has a positive and significant effect on the quality of financial reporting ($\beta 1= 0.417$, $\rho<0.05$). However, findings showed that audit committee independence had a negative and significant effect on the quality of financial reporting ($\beta 2= -0.478$, $\rho<0.05$). The findings indicated that increase in audit committee size *increases quality of financial reporting. This implies that an increase in the audit committee size enables the members to distribute the workload and dedicate more time and resources in monitoring. These findings will also have policy implications as regulators around in Kenya continue to define and refine the desired characteristics and behavior of audit committees. Therefore, the findings of this study will ensure future platforms changes regarding audit committees are adequately informed.*

Keywords: Audit Committee Characteristics, Quality of Financial Reporting, Audit Committee Size, Audit Committee Independence

INTRODUCTION

Financial reporting is an important determinant of investment efficiency. Previous literature reveals that improved level of financial reporting leads to high and more efficient level of investment (Bushman and Smith, 2001; Healy and Palepu, 2001; Lambert, Leuz, and Verrecchia, 2007). Biddle and Hilary (2006) argued that organizations that possess more enhanced level of financial reporting possess a lot of returns in their investment ventures. The major aim of financial reporting is to make sure that there is enhanced methods of interpreting financial records and statements and to enable individuals who invest in various ventures to have the right information that will aid in making accurate financial resolutions together with improving the level of market performance (IASB, 2008).

Having the ability to use financial data effectively is very important to investors since it allows them to have more confidence in themselves about the business decisions that they make. The decisions made enable them to allocate resources where they are most needed hence improving the level of market performance (IASB, 2006; IASB, 2008). As accounting earning is being reported in the published financial reports of firms, it is expected to provide a timely and reliable input to various stakeholders, shareholders, potential investors, employees, suppliers, creditors, financial analysts , stockbrokers, management, and the government agencies – useful in making prudent, effective and efficient decisions (Umoren, 2009).

Audit committee of corporate board of directors has received broad-based support for many years as a key factor for more efficient level of corporate governance. Their major function is to oversee the process of financial reporting so as to make sure that all transactions are recorded accurately so as to have more reliable and accurate financial data. Inaccurate reporting of firm performance by manipulating financial numbers is detrimental to shareholders' value because shareholders get false information which may result in higher information asymmetry and higher cost of capital (Liao, 2013). Functions of the audit committee in overseeing the process of financial reporting majorly depends on how independent the personnel within the audit committee are in conducting their functions (Klein, 2002), the expertise of audit committee members (Dhaliwal *et al.,* 2010) and the overlapping membership on audit and remuneration committees (Chandar *et al.,* 2012).

Previous study by Walker (2004) on audit committee's works links communication network between internal and external auditors and the board of directors, and their activities include analysis of nominated auditors attributes the ability of audit committees as the organizations agents to their characteristics leading to overall range of the audit results and internal financial controls and financial information for publication (FCCG, 1999). In Kenya, as noted by CMA (2010), Nairobi Securities Exchange (NSE) is the single major open capital market in the country. It differs from those developed markets in such characteristics on firm levels as board characteristics and size, asset structure, profitability, firm size and corporate governance standards (CMA, 2010) making it a unique context of this study. For a long time, companies at the NSE operated without clear control and directorship structures, presenting corporate governance concerns among stakeholders. Reforms have since given rise to corporate governance guidelines and principles which, among other things, improved the process and structures used to oversee the activities within the organization and corporate accounting with the ultimate objective of realizing shareholders' long-term value while taking into account the interests of other stakeholders (CMA, 2000). However, it is not apparent how audit committee characteristics reforms have impacted on quality of financial reporting. Weaknesses in corporate governance, inaccurate procedures and the general absence of transparency in the corporate sector, pervade the corporate financial reporting regime in Kenya. However, Kenya does not have any rules relating to mandatory rotation of audit firms but there are guidelines within the ethical standards regarding partner rotation (Crowe Horwath International, 2016).

The quality of financial reporting is important for the efficient allocation of resources in capital markets. Quality of financial reporting does not only mean earnings or stock price changes, but it is a multi-dimensional term that requires comprehensive measures of quality accounting information (IASB, 2008). In addition, the wave of recent scandals and loss of billions of shillings of investments in state corporations in Kenya, timeliness in reporting and disclosure quality has been questioned. Two business indices used in Kenya in 2009; Business Indicator Index (KIBII) ranked Kenya at 71 out of 100 countries with a score of 6.48 out of full score of 12 while E-standards forum index ranked Kenya at 72 out of 100 (Outa, 2011). These two indices showed that Kenya compliance with International Financial Reporting Standards (IFRSs) was quite low.

The fact that a number of Kenyan banks failed recently, and the audited financial statements did not provide early warning signals about these failures, has raised concerns among the general public about the quality of financial reporting in the country. The collapse of such large corporations highlighted the intentional misconduct due to the weakness of corporate governance particularly audit committees, as they were not effective enough to protect investors from loss. Companies have gone into liquidation for reasons bordering on ineffective or non-existing system of audit committee. Examples of banks liquidated in Kenya in the year 2016 by Central bank of Kenya (CBK) are Imperial bank and Chase bank.

Recent research suggests that effective audit committee characteristics are fundamental determinants of high-quality financial reporting (La Porta *et al.,* 1998; 2000; 2006; Leuz *et al.,* 2003; Ball *et al.,* 2000; Ball *et al.,* 2003; Nabar and Boonlert U-Thai 2007; and Daske *et al.,* 2008). The work of Ugbede *et al.* (2013) and Leslie and Okoeguale (2013) used one independent variable (Audit committee size). Similarly, Fodio *et al*. (2013) used two variables (audit committee size and audit committee independence). Hassan (2012) used three independent variables; audit committee size, independence and audit committee meetings. Despite studies confirming that financial reports still remain the most important source of externally feasible information on companies, there are limited empirical reviews explaining how audit committee characteristics affect quality of financial reporting.

The study therefore assessed the effect of audit committee size and audit committee independence on the quality of financial reporting. And, tested the following hypotheses;

H_{o1}: *Audit committee size has no significant effect on quality of financial reporting*

H_{o2}: *Audit committee independence has no significant effect on quality of financial reporting*

THEORETICAL REVIEW

This study has adopted agency theory to explain the relationship between audit committee and quality of financial reporting in listed firms in NSE, Kenya. Proponents of agency theory; Jensen and Meckling (1976) assert that putting apart how businesses are owned and managed could result into disagreements among managers and stakeholders. Varying people that have the same goal or function in doing a specific task have different motivations, and these differences can manifest in divergent ways. Agency theory is therefore concerned with contractual relationship between people that are termed as agents and are assigned to do functions to represent another individual who has employed them. This makes many firms and organizations to come up with methods through which they can establish controls so as to reduce costs that come with irregularities (Kalbers and Fogarty, 1998). Similarly Pincus *et al.* (1989) argue that audit committees are used primarily in situations where agency costs are high to improve the quality of information flows from the agent to the principal.

According to the agency theory, to ensure the effectiveness of an audit committee, managers are encouraged to come up with financial statements that clearly show the amount of revenues that a company gets within a specific period in time. Ensuring that the audit committees do their functions allows the company to create and putting place accurate financial records and statements to achieve high performance. According to Felo *et al.* (2003) there is a positive correlation between the existence of audit committee and the accuracy of financial statements.

However, Salah (2010) in Rauf *et al.* (2012) suggests that, management could use earnings to mislead shareholders by showing a different image of the company's earnings. For the purpose of this study, agency theory is adopted. This is due to the fact that it enlightens the relationship between the principal (shareholders) and the agents (management). In the same vein, audit committee, apart from serving as monetary measures, equally represents the shareholders who are the principal since their composition constitutes equal number of shareholders and directors. The directors therefore are acting on behalf of the shareholders. While the other aspect of the agency theory are the management (agents) who are responsible for the preparation and fair presentation of financial statements in accordance with IFRS, they also suppose to ensure financial statements are free from material misstatement, whether due to fraud or error. This is concluded by the audit committee subject to confirmation, review and verification in order to make sure that the accounting policies are in line with the legal requirements and ethical practices. Therefore agency theory is found to be relevant because it explains the audit committee which functions as a monitoring mechanism to reduce agency cost (Menon Williams 1994).

EMPIRICAL LITERATURE REVIEW

The section presents empirical studies on effect of audit committee size, independence gender and experience on quality of financial reporting.

Effect of Audit Committee Size on Quality of Financial Reporting

Previous researches have argued that audit committees are used to control the quality of financial reporting in place. Anderson *et al.* (2004) found that a small audit committee enhances firm value. They asserted that having a small number of board members improves the efficiency of audit committee monitoring and control. Boards that have a big audit committee tend to have a lot of delays in their work. Anderson *et al.* (2004) argues that boards that contain a large composition are able to take their time in ensuring that financial reports are done conclusively and hence maintain high financial performance. The big audit committee size makes the different board members to be assigned a specific work area and commit more time and resources to monitor management and detect fraudulent behavior thus improving the quality of financial reporting.

Hamdan and Mushtaha (2011) conducted a research to ascertain the correlation between the probability of a firm getting an audit clean report together with the traits of the audit committees in Jordanian companies listed in Amman Stock Exchange. The results revealed a positive impact for the size of the audit committee members on the financial report of external auditor.

The study of Mazlina *et al.* (2006) tried to test the relationship between size of the audit committee and its effect on financial reporting. The study was conducted by designing and issuing a questionnaire to internal executive auditors in 76 general Malaysian companies listed in the financial market. The most important finding was that there was a positive relationship between size of the audit committee and quality of financial reporting.

Resource dependency theory argues that larger audit committees are likely to devote greater resources and authority to effectively carry out their responsibilities (Alleging and Greco, 2011). More directors on audit committee are more likely to bring diversity of views, expertise, experiences, and skills so as to enhance more accurate financial reporting. According to this an audit committee that is large in size is able to efficiently carry out its functions of financial monitoring. Therefore size is a crucial factor for AC to adequately oversee corporate disclosure practices (Persons, 2009).

Raghunandan and Rama (2007) argued that the size of audit committee increases the number of meetings. This increase in meeting frequency is argued to provide more effective monitoring and hence better financial reporting.

Anderson *et al.* (2004) found that smaller boards are associated with higher quality monitoring. Their study showed that companies with smaller boards could shape the Chief Executive Officer (CEO) to have a good reputation in terms of accuracy of their financial records and forms of reporting therefore enable them to get a huge level of the market share in accordance to the amount of valuation. The expectation that the problem cannot be prevented; increased the effective function of the large audit committee to spot potential problems in financial reporting. Also if the audit committee is huge they are a lot more prone to fall into the pressures and more subject to follow the others' opinion without giving their own arguments.

The size of the audit committee improves quality of financial reporting and internal control systems within a firm (Anderson *et al.,* 2004) and facilitates discussions between the audit committee members (DeZoort and Salterio, 2001). Empirical evidence shows that companies with greater audit committee size have better financial report than those with small audit committee size (Archambeault and DeZoort, 2001) and more likely to have lower costs of debt (Anderson *et al.,* 2004).This implies that firms who have at least three directors in the audit committee have a strong relationship between audit committee size and quality of financial reporting.

Effect of the Audit Committee Independence on Quality of Financial Reporting

Audit committees independence is the number of independent non-executive directors in the audit committee. Independence of audit committees helps to ensure that management is transparent and is held accountable to stakeholders (BRC, 1999). It is expected that independent audit committee are thorough in their work hence they are not likely to not see major or minor financial errors that happen during or in the process of financial reporting. According to Abbott *et al.* (2004) there is sufficient evidence to ascertain that independence of the audit committee significantly affects the rate of quality financial reporting and vice versa.

Klein (2002) posited that independence of audit committees increases with audit committee and board independence. Beasley *et al* .(2000) found that AC independence is significantly related to quality. This is due to the fact that misstatements in financial reporting are most likely to come about due to lack of independence of the audit committee. According to Lin *et al.*(2006) there is no correlation between audit committees who are independent and earnings restatements. Xie *et al.* (2003) on the hand asserts that there is a significant relationship between the level of discretionary accruals and an independent audit committee.

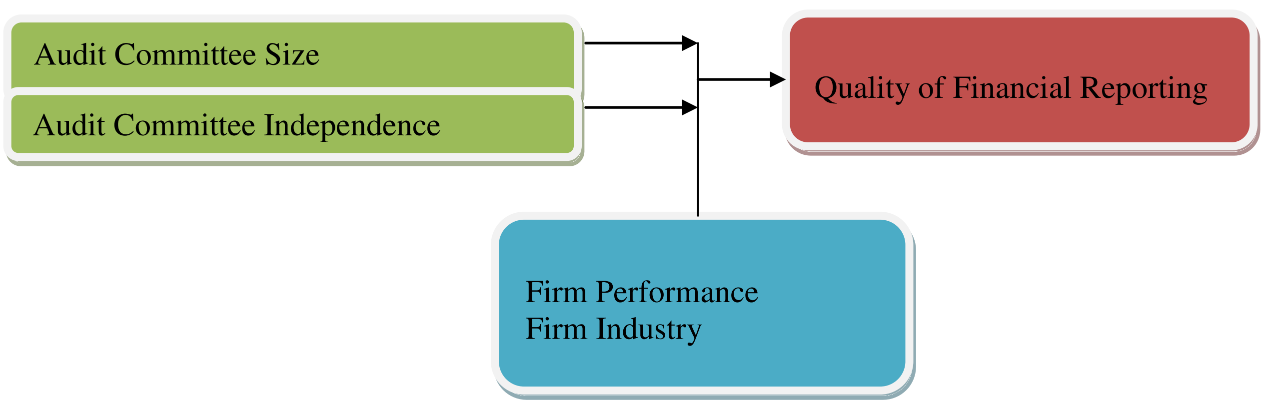
Based on agency theory, Bedard (2010) asserts that more independent directors are more likely to be keen in their work without outside influence hence able to efficiently monitor the process of financial reporting. It is attributed to the fact that independent directors in the audit committee have no other motive other than to carry out the work that they were assigned to do (Greco, 2011). Hence, an AC with independence enhances quality and of financial reporting hence reveals all to provide accurate and additional information in quick information processing (Haniffa and Cooke, 2002). Akhtaruddin and Haron (2010) and Patelli and Prencipe (2007) have found that AC independence is associated with more voluntary disclosure.

Abbott *et al.* (2000) show that firms with audit committees which are composed of independent directors and conduct meetings mainly two times in a year. Audit committee independence affects companies' earnings, management and also investors' perceptions. Klein (2002) indicates that reductions in audit committee independence are accompanied by large increases in abnormal accruals.

Raghunandan and Rama (2004) document efficient audit committee sizes are able to determine the shareholders decisions. Mustafa and Meier (2006) in their study showed that the percentage of independent members in audit committees and the average time they are assigned to do the work together with the matched models while the number of audit committee meetings was not significant.

Drawing from agency theory and previous studies' the independent variables in the study were AC size and independence are assumed to relate with quality of financial reporting (dependent variable). Audit committee size was measured as number of audit committee members in the firm. AC independence was measured by ratio of non-executive members to total members in audit committee. The conceptual framework is presented in figure 1.

Figure 1: Conceptual Framework



RESEARCH METHODOLOGY

The study adopted explanatory research design. The target population was 64 listed firms trading at the NSE. The sample size of the 46 firms was arrived after eliminating the number of firms delisted, suspended, terminated and with missing data. This study utilized secondary data obtained from the annual financial statements reports of listed firms, annual investors' reports, magazine and articles. A document analysis guide prepared to guide collection of data. Data collected was analyzed by using both descriptive and inferential statistics.

The model which was used in this study is given as;

$$Y = \beta_0 + \beta_1 FP_1 + \beta_2 FI_2 + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 1$$

Y is the quality of financial reporting measured by use of accruals quality as a proxy for financial reporting; β_0 is the constant of the equation; $\beta_1, \ldots\ldots, \beta_4$ are parameters to be estimated; FP_1 is the firm performance and; FI_2 is the firm industry.

$$Y = \beta_0 + \beta_1 ACZ_1 + \beta_2 ACIx_2 + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 2$$

Where;

Y is the quality of financial reporting measured by use of accruals quality as a proxy for financial reporting; β_0 is the constant of the equation; $\beta_1, \ldots\ldots, \beta_4$ are parameters to be estimated; ACZ_1 is the audit committee size; ACI_2 is the audit committee independence and; ε is the error term.

The measurements of the independent, dependent and control variables are summarized in the table 1.

Table 1. Measurements of Variables

Variable Name	Measurement of Variables	Author(s)
Dependent Variable Quality of Financial Reporting	Measured by use of accruals quality as a proxy for financial reporting which equals change in current assets - change in cash - change in current liabilities + change in short term debt-depreciation) /scaled by average total assets	Dechew and Dichev (2002) Kothari *et al.* (2005)
Independent Variables		
Audit committee size	Measured as the number of members of the audit committee at year end	Taliyang and Jusop (2011)
Audit committee independence	The audit committee independence was be measured as ratio of non-executive members to total number of AC members	Jing Li *et al.* (2012)
Control Variables		
Firm Performance	Measured using return on asset ratio. It is define as total revenue divided by total assets. This measure of firm performance	Cole (2000)Kato and Long (2006)
Firm industry	Rated 1 for industrial and allied 2 for commercial 3 for financial 4 is Agricultural sector	(Roberson and Park, 2007)

Hypothesis was tested at 0.05 level of significance (95% confidence level).

RESULTS AND DISCUSSIONS

Findings showed that the firms listed in NSE had an average of four members in the audit committee (mean = 3.76) with 90 percent of the members being independent directors (mean = 0.901). More findings showed that quality of financial reporting in NSE were at a mean of -0.1146, this shows that there is weak quality of financial report. Firm performance had an average mean of 0.77 indicating most of the firms in NSE were financially performing well. A summary of findings is presented in Table 2.

Table 2. Descriptive Statistics

	N	Min	Max	Mean	Standard Deviation	Skewness	Kurtosis
Ac Size	46	2.00	5.00	3.76087	0.82151	-0.276	-0.304
AC Independence	46	0.333	1.00	0.90126	0.17254	-1.639	1.783
Firm Performance	46	0.00	2.77	0.76791	0.762254	1.074	0.279
QFR	46	-0.69	0.88	-0.1146	0.23298	1.174	1.843

Diagnostic Statistics

Before running regression model, it is necessary to ensure model assumptions are valid. If there are any violations, subsequent inferential procedures may be invalid resulting in faulty conclusions. Therefore, it is crucial to perform appropriate model diagnostics. This section gives a description of the robustness tests conducted in order to improve the validity of all statistical inferences. The tests include; linearity, normality, homoscedasticity and autocorrelation.

The study tested linearity using ANOVA model. Findings indicated that there was linearity for quality of financial reporting versus audit committee size ($\rho < 0.05$). This was also confirmed by deviation from linearity which had ρ value >0.05). Similarly, quality of financial reporting versus audit committee independence had linearity p value less than 0.05, while deviation from linearity had ρ value more than 0.05. Moreover, quality of financial reporting versus audit committee gender, quality of financial reporting versus audit committee experience, quality of financial reporting versus firm performance had linearity with $\rho < 0.05$, and deviation from linearity had $\rho > 0.05$. This indicates the assumption of linearity was not violated.

Kilmogorov-Smirnov statistic was not significant ($\rho > 0.05$) and therefore the distribution is normal. In addition, also Shapiro walk was not significant ($\rho > 0.05$) indicating that the distribution of the data was normal. This infers that the sampling distribution of the mean is normal and the distribution of means across samples is normal. Therefore, statistical errors such as outliers have been catered for.

The study tested homoskedasticity using White test. The findings indicated that Chi^2 (16) was 27.35 (ρ = 0.8027 revealing that null hypothesis was rejected suggesting that assumption of homoskedasticity was not violated. In addition, residual scatter plots were used to test the assumption homoscedasticity between the predicted dependent variable scores and the errors of prediction.

The variance inflation factors(VIF) and tolerance values were computed and found to be consistently smaller than ten and one respectively indicating absence of multicollinearity (Neter *et al.*,1996). The VIF values were less than four meaning that there was no multicollinearity while for tolerance should be above 0.2.

Findings show a Durbin-Watson 2.098 which is between1.5-2.5 indicating minimal autocorrelation which does not influence the outcome of regression results. Hence, the assumption was met.

Correlation Statistics

The study analyzed the relationships that are inherent among the independent and dependent variables. Table 3 presents Pearson correlation results. Findings revealed that audit committee independence was negatively and significantly correlated with the quality of financial reporting (r = -0.466, ρ<0.01) Further, audit committee gender was positively and significantly correlated with the quality of financial reporting (r = 0.391, ρ<0.01), audit committee size had significant and positive effect on quality of financial reporting (r = 0.374, ρ<0.01). Moreover, firm performance was positively correlated with the quality of financial reporting (r = .303, ρ<0.01).

Table 3. Correlation Statistics

Independence	QFR	AC Size	AC Independence	Firm Performance	Firm Industry
QFR	1				
AC Size	.374*	1			
AC Independence	-466**	0.161			
Firm Performance	.303*	-0.058	-0.01	1	
Firm Industry	0.054	-0.269	-0.22	.337*	1

* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

Regression Analysis

The R- squared result shows that a unit change of firm performance, audit committee experience, independence, gender, size and firm industry will lead to about 58.6 percent change in QFR (R squared =.586). This is complimented by the Adjusted R Squared of about 52.1 percent. In others words, audit committee independence, gender and size explains 52.1 percent variation in QFR. The significant value of the F- Statistics further justifies that the model is not biased. A summary is given in table 4. The study used another method to test Goodness of fit of the model whereby none of the parameters is equal to zero. Study findings in table 4.8 indicated that there was goodness of fit and none of the parameters was equal to zero as evidence of F ratio of 8.964 with ρ value 0.000 <0.05 (level of significance). Thus, the model was fit to predict the quality of financial reporting using audit committee size and audit committee independence.

Hypotheses Testing

The first hypothesis stated that audit committee size has no significant effect on the quality of financial reporting was rejected. Study findings revealed that audit committee size has a positive and significant effect on the quality of financial reporting as evidenced by ($\beta 1= 0.417$, $\rho<0.05$).Consistently, Reeb (2004) states that large boards can devote more time and resources to monitor the financial reporting process. Hamdan and Mushtaha (2011) espoused that there is a positive impact of the size of the audit committee members on the financial report of external auditor. This was also the case with the study of Mazlina *et al.* (2006) which found that there was a positive relationship between size of the audit committee and quality of financial reporting. Besides, Alleging and Greco, (2011) posit that larger audit committees are likely to devote greater resources and authority to effectively carry out their responsibilities.

The second hypothesis stated that audit committee independence has no significant effect on the quality of financial reporting. However study findings showed that audit committee independence had a negative and significant on the quality of financial reporting as shown by ($\beta 2= -0.478$, $\rho>0.05$).Contrary to the results, Beasley *et al.* (2000) found that audit committee independence is significantly related to financial reporting quality. The study argued that, financial statement fraud is more likely to happen in firms with less audit committee independence. Furthermore, Bedard and Gendron (2010) argued that the effective monitoring of management's behavior is more likely to be influenced by the presence of independent directors.

The results are also contrary to that of Allegrini and Greco, (2011) indicating that independent directors on audit committee have more opportunity to control and reduce management's opportunities to withhold information for their own benefits. Haniffa and Cooke, (2002) elucidate that the presence of independent directors in the audit committee motivates management to provide accurate and additional information in quick information processing. Zainal *et al*. (2009) found that a higher proportion of independent non-executive directors enhance quality of financial reporting. Consistent with this proposition, Klein (2002) indicates that reductions in audit committee independence are accompanied by large increases in abnormal accruals. However, Lin *et al.* (2006) reported no evidence of a relationship between audit committees having independent members and earnings restatements. Similarly, Xie *et al.* (2003) found no evidence of a significant relationship between the level of discretionary accruals and an independent audit committee. From the preceding prior literature, it is evident that audit committee independent has a mixed relationship with the quality of financial reporting. Table 4 presents a summary of the regression results.

Table 4. Regression Analysis Hypotheses Testing

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	-0.096	0.183		-0.523	0.604		
Control Variables							
Firm Industry	0.003	0.011	0.039	0.291	0.773	0.62	1.612
Firm Performance	0.082	0.035	0.268	2.34	0.025*	0.83	1.205
Independent Variables							
Audit Committee Size	0.118	0.034	0.417	3.428	0.001*	0.735	1.36
Audit Committee Independence	-0.645	0.148	-0.478	-4.372	0.000*	0.912	1.096
Summary statistics							
R Square	0.586						
Adjusted R Square	0.521						
F	8.964						
Sig.	.000						

CONCLUSION AND RECOMMENDATIONS

The study results show that the audit committee size has a positive and significant effect on the quality of financial reporting. This implies that an increase in the audit committee size enables the members to distribute the workload and dedicate more time and resources in monitoring. The result is that fraudulent behaviors are detected thus improving the quality of financial reporting. Larger boards also bring on board diversity of views, expertise and experience which are of essence in enhancing the quality of financial reporting.

Additionally, the study findings have show that audit committee independence has a negative and significant effect on the quality of financial reporting. However, as evidenced in the extant literature, Bedard and Gendron (2010); Allegrini and Greco, (2011) and Xie *et al.* (2003), a higher proportion of independent directors on audit committee enhance the quality of financial reporting. This is due to the fact that the independence of audit committees helps to ensure that management is transparent and discloses accurate information. The eventual outcome is quality of financial reporting. The results are however contrary to this notion. There is thus need for further research on the same to assess the validity of this concept.

The study has indicated that the audit committee size has a positive and significant effect on the quality of financial reporting. As such, an audit committee of a minimum of three members and a maximum of five is of essence to firms. This is so because, the audit committee can be efficient if there are five members since members with different skills, views and expertise are brought on board. Also, such a audit committee is unlikely to be encumbered with delays and administrative bottlenecks. Moreover, greater resources and authority are devoted which improves the quality of financial reporting.

As much as the study has found a negative relation between audit committee independence and the quality of financial reporting, it is utmost necessary to have audit committee independence as noted in the literature. There is need for a further study that makes use of a larger data set so as to assess whether the negative relation between audit committee independence and the quality of financial reporting is valid.

This study has analyzed the effect of audit committee characteristics on quality of financial reporting among firms listed in Nairobi Securities Exchange, Kenya. This study found that audit committee experience has no significant effect on the quality of financial reporting. This finding is inconsistent with prior studies where audit committee experience was found to have a significant effect on quality of financial reporting.

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