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Audit Committee and Performance: Evidence from Kenyan Deposit Taking Saccos

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ABSTRACT: *This research examined the effect of Audit committee characteristics on performance of Deposit Taking Saccos in Kenya. Audit committee characteristics was measured by independence, terms of service and study specialization as proxy. The study was guided by the Agency Theory and adopted descriptive cross-sectional survey and correlational research designs. A sample size was 108 licensed Deposit Taking Saccos drawn from a target population of 175. Primary data was collected from the board members and management executives. The analysis was done using descriptive statistics and multiple regressions. The study findings suggest that the overall correlation coefficient for Audit Committee characteristics and performance was found to be 0.144 with a p-value of 0.143> =0.05. This implies a weak positive and insignificant relationship between Audit Committee characteristics and performance. Based on findings, the study recommends proper constitution of audit committee with well spelt out terms of service and a consideration be made on appropriate study specialization. Independence of audit committee must be complied with to ensure conformity to best standards of practice. Areas for further studies suggested are conducting studies in other contexts to corroborate these findings and consideration of effect of other variables of Audit Committee characteristics on the performance.*

KEYWORDS: audit committee characteristics, performance, saccos

INTRODUCTION

The audit committee is a key component of an organization's governance structure (Szczepankowski, 2012). Audit committee is an internal corporate governance mechanism just like the board of directors (The Institute of Internal Auditors, 2014; Republic of Kenya, 2002; Yahya, Al-Swidi, Hanim, Fadzil and Al-Matari, 2012) that can improve it (The Institute of Internal Auditors, 2014; Republic of Kenya, 2002; Waweru, Kamau and Uliana, 2011). Wong

(2012) defined Audit committee as an independent sub-committee of the board with a mandate of assisting top management to discharge their responsibilities, achieving governance, obtaining independent assurance, and overseeing the financial reporting process. An audit committee is not only a group of persons, but also a set of processes, policies, laws, and institutions affecting the way a corporation is directed, administrated, or controlled (Szczepankowski, 2012) and provides an oversight in key governance, risk management and internal control practices (The Institute of Internal Auditors, 2014).

Past financial scandals have brought into focus the effectiveness of audit committee with the regulators enacting changes in recent years (Zheng, 2008). The effectiveness of an audit committee is having members with an appropriate mix of skills and experience relevant to the organization's responsibilities. In this study, audit committee is operationalized as independence, terms of service and study specialization. Independence is the key underpinnings of corporate governance. Audit committees should be independent to carry out their responsibilities with due professional care (Ebrahim, Abdullah and Faudziah, 2014). Past studies (Kyereboah-Coleman, 2007; Saat, Karbhari, Xiao and Heravi, 2012) have demonstrated that relatively independent, skilled, and resourced audit committees enhance performance of corporate entities.

Corporate governance reformists and policy makers have advocated for consideration of financial expertise in the constitution of audit committee (United States, 2002; Siam, Laili and Khairi, 2014; Republic of Kenya, 2015). The complex nature of financial reporting has compelled governance regulators to show a considerable interest in the financial expertise of audit committee members. Experience and expertise in financial and accounting matters provides basis for monitoring quality of financial reporting and adequate understanding of an internal control oversight task (Ghafran, 2013). Hamdan, Sarea and Reyad (2013) opined that increasing number of financial experts as a positive impact in raising the quality of financial performance. The tenure of audit committee directors on the board is another important factor in determining the effectiveness of audit committees in performing their monitoring role (Ghafran, 2013). Longer tenure allows the members of the audit committee to gain more firm-specific knowledge. However, longer tenure might compromise committee's independence by bringing directors and management closer resulting in directors 'befriending' management. The Combined Code (2008) advocated for progressive refreshing of the Board to secure the independence.

In Kenya, apart from the commercial banking sector, Deposit Taking Saccos remain the single largest formal financial credit service provider to household economies in Kenya (SASRA, 2018). This is attributed to fact that the members' savings can be treated as collateral for borrowing at the same time earn interest from the surplus made by the SACCO. Though the sub sector has witnessed rapid growth, it remains confronted with a host of governance challenges. Sacco Societies Regulations 2010 was enacted as a fundamental change to address these challenges and respond to the evolving and changing needs of Kenyan society. The purpose of SACCO Societies Regulations 2010 and development of corporate governance guidelines for the Deposit Taking Saccos was to address bad corporate governance among other issues.

Key to this governance discourse is the role of audit committee. According to Osevwe-Okoroyibo and Emeka-Nwokeji (2021), interest in the role of audit committees has been on the increase given the number of financial statement fraud and high corporate failures in both developed and developing economies. Establishment of audit committee has been a commoner feature in the recommendations resulting from investigations of the many fraud and corporate failures. Audit committee remain an important internal governance mechanism that the industry players must ensure it is effective in serving it functions. According to Kurawa and Shuaibu, (2022) the effectiveness of audit committee depends on how independent, experienced, and well-resourced members of the committee are.

Previous studies on this topic remains biased. For instance, in Jordan, Hamdan, Sarea and Reyad (2013) studied the impact of audit committee characteristics on the performance of listed companies in Amman Stock Exchange Market. Similarly, Kipkoech and Rono (2016) focused on the effects of audit committee size and experience on firm performance among listed firms in Nairobi securities exchange. Maina and Oluoch (2018) focused their study on manufacturing firms in Kenya. In Nigeria, Osevwe-Okoroyibo and Emeka-Nwokeji (2021) examined effect of different audit committee attributes on performance of firms listed in the food and beverage industries in Nigeria Stock Exchange. Henry, Duncan, and Robert (2022) sought to determine the effects of audit committee characteristics on internal audit effectiveness in the devolved units in Kenya. Oluoch and Nasieku (2018) sought to identify the relationship between audit committee characteristics and the audit expectation gap within the public sector in Kenya. In 2019, Ashari and Krismiaji undertook research to investigate the effect of audit committee characteristics on the financial performance of manufacturing firms listed on the Indonesian Stock Exchange. Though Machora and Oluoch (2019) and Oduor, Adoyo and Mule (2022) focused on Sacco subsector, their studies had both contextual and conceptual gaps. Evidently, despite the importance of Sacco subsector to Kenyan economy, there is little empirical investigation that has been carried out. Based on the reviewed literature, it is important to assess how Audit Committee characteristics influences performance of Deposit Taking SACCOs in Kenya. This study focused on some of the most common characteristics of audit committee namely, independence, terms of service and study specialization.

Theoretical Framework

This study was anchored on Agency Theory (Berle and Means, 1932). Mitnick (2019) asserts that Agency theory was propounded by Stephen Ross and Barry Mitnick in 1973, independently and roughly concurrently. Agency theory argues that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximize shareholder returns (Berle and Means, 1932). The domain of agency theory is relationships that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behaviour (Jensen and Meckling 1976; Eisenhardt, 1989), but have differing goals and differing attitudes toward risk (Eisenhardt, 1989). In agency theory terms, the owners are principals, the managers are agents, and there is an agency loss, which is the extent to which returns to the residual claimants, the owners, fall below what they would be if the principals, the owners, exercised direct control of the corporation (Jensen and Meckling 1976). Eisenhardt (1989) opined that two agency problems arises when the desires or goals of the principal and agent conflict and it is difficult or expensive for the principal to verify what the agent is doing. Agency theory is concerned with resolving the problems that can occur in agency relationships. The principals cannot verify that the agent has behaved appropriately. The corporate governance concept provides mechanism to solve conflicts associated with principal-agent relationship. Agency theory specifies mechanisms, which reduce agency loss (Eisenhardt, 1989). One such mechanism is imposition of internal controls through constitution of audit committee.

In this study, the agency theory aids in understanding the importance of good corporate governance practices with the “principal-agent” or “agency” problem. Primarily, the audit mechanism as a key internal dimension of corporate governance, provides an independent review of the financial position of the organisation (Ebrahim *et al*., 2014). This implies that the principals have to minimize the agency costs by imposing internal controls (Jensen and Meckling, 1976; Davis, Schoorman and Donaldson, 1997). For Saccos they are required by law to constitute an audit committee. In this case, the audit committee act as agents to principals when performing an audit. Audit mechanism limits the agent's self-serving behaviour. The audit autonomy and independence help in making of the right decision without any restriction or condition. In this study, this theory helps in providing an explanation of the role of the Audit committee in the corporate governance debate. In this study, Agency theory postulations provides a basis for conceptualization of audit committee as an important dimension of corporate governance.

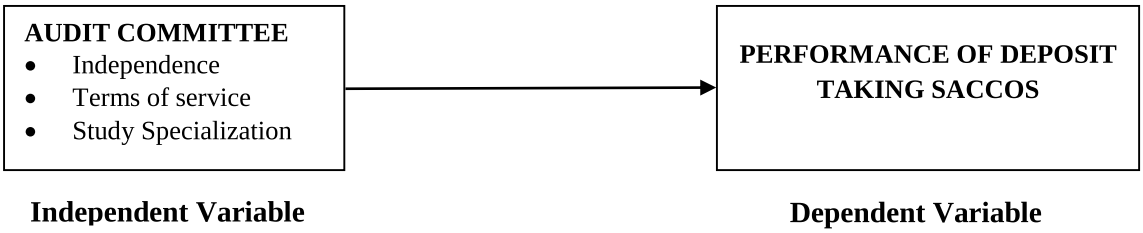

Figure 1.1: Conceptual Framework

Empirical Review

In Jordan, Hamdan *et al.* (2013) studied the impact of audit committee characteristics on the performance of 106 companies listed in Amman Stock Exchange Market for the period 2008-2009. The audit committee characteristics studied were audit committee size, financial experience, and audit committee independence. Performance included financial, operating and stock performance in which data was compiled from the financial statements and the publicly available database of the Amman Stock Exchange. normal distribution test, Multicollinearity test, the Autocorrelation test and the Homoskedasticity test were carried out. Descriptive statistics, inferential statistics and multiple regressions of Ordinary Least Squares were adopted. The study findings show there was positive relation with statistically significant between audit committee characteristics and financial performance. They also found no relation between audit committee characteristics and operational performance, while there was positive relation with statistically significant between audit committee characteristics and stock performance in the financial sector listed in Amman Stock Exchange Market.

Guided by agency and institutional theories, Kipkoech and Rono (2016) sought to establish the effects of audit committee size and experience on firm performance among listed firms in Nairobi securities exchange, Kenya for the period ranging from 2006 to 2011. The study target population was 60 listed firms. This study utilized secondary data, which was sourced from the annual financial statements reports, annual investors' reports, magazines and articles related to the financial performance of listed firms. Content analysis was used. They adopted an explanatory design and used Multiple Regressions to test hypothesis. They found that audit committee experience showed a positive and significant effect on firm performance (β= 0.331, ρ<0.05) while audit committee size showed a negative and significant effect on firm performance (β= -0.213, ρ<0.05). They recommended similar studies but in different contexts, consideration of different indicators of audit committee and introduction of moderator factors in the research models.

Maina and Oluoch (2018) sought to establish the effect of corporate audit committee characteristics on financial performance of 766 manufacturing firms in Kenya for a period of 5 years, 2013-2017. Audit committee characteristics studied were composition and frequency of meetings while financial performance was measured by ROA. Their study was anchored on Agency, institutional, and stewardship theories. The research design for the study was descriptive research design while Krejcie and Morgan's sampling technique was used to calculate the sample size of 260 audit committee chairs out of population of 766. Their study collected both secondary and primary data. Multiple linear regression analysis was used. Maina and Oluoch (2018) found a significant relationship between audit committee composition, audit committee meetings frequency and firms Financial Performance.

Oluoch and Nasieku (2018) adopted a positivism philosophy and a descriptive research design in their study. They sought to identify the relationship between audit committee characteristics and the audit expectation gap within the public sector in Kenya. The study was in the background of internal and external interference of audit committee with regards to their composition and workings. Based on the study findings, Oluoch and Nasieku (2018) recommend that organizations should consider gender inclusion and individual competencies as they constitute audit committees. Further, they recommended an appropriate skill mix within the audit committee to ensure conformity to best standards of practice. In 2019, Ashari and Krismiaji undertook research to investigate the effect of audit committee characteristics on the financial performance of manufacturing firms listed on the Indonesian Stock Exchange. Audit committee characteristics understudy included independence, size, competence, and frequency of meetings. Ashari and Krismiaji (2019) found that all the characteristics of audit committee positively affect the company's performance.

In their contribution to this debate, Zraiq and Fadzil (2018) used OLS regression to test the relationship between independent variable and dependent variable. They were examining the association between audit committee and firm performance of the Jordanian firms. The data comprised of 228 firms industrial and services. The findings indicated a positive direction but insignificant relationship between audit committee size and ROA. Whereas audit committee size with EPS is positive direction and significant. Furthermore, the result shows audit committee meetings significant and positive direction with ROA. Correspondingly, audit committee meetings with EPS represent positive direction but insignificant. Zraiq and Fadzil (2018) recommended introduction of moderating variable in this relationship that would lead to an improvement on performance. Further, future studies explore in- depth the relationship between audit committee with performance, by adding new variables such as expertise, educational and independence.

Similarly, Bouaine and Hrichi (2019) contributed to this research by examining the impact of legal creation of audit committees on financial firm performance. Their study was on the background of enactment of Ordinance No. 2008-1278, on financial firm market performance. Audit committee was measured by independence of the members of the audit committees, the size; the accounting and financial expertise of the committee members as well as the frequency of audit committee meetings determine financial performance. Bouaine and Hrichi (2019) conducted a panel study for a sample of 100 French companies listed on the Paris Stock Exchange from 2007 to 2015. Findings show that the establishment of the audit committee has no significant effect on the company's performance.

Machora and Oluoch (2019) sought to establish the effect of audit committee characteristics on financial performance among deposit taking SACCOs. The audit committee indicators were the committee size, composition, and independence while performance was measured by ROA and ROE. The study was founded on Agency theory. Their study adopted a descriptive research design, specifically it was a census study with a target population of 166 employees working in five selected Saccos in Kisii County, Kenya. Machora and Oluoch (2019) found that some of the Audit Committee characteristics were associated with firm performance. Further, the results indicated that independent members with Accounting/Finance background, chair experience, and number of external directorships negatively impacted firm performance while a longer tenured Chairman and larger firm size impacted positively on performance.

Osevwe-Okoroyibo and Emeka-Nwokeji (2021) examined effect of different audit committee attributes on performance of firms listed in the food and beverage industries in Nigeria Stock Exchange. The proxy for measuring audit committee attributes included audit committee independence, audit committee financial expertise and audit committee meeting, while financial performance was measured with Earning Per Share. Their study was an attempt to explore literature on audit committee attributes within an important sector which had received little attention in Nigeria. Further, their study was undertaken in the background that previous studies, which were few provided contradictory evidence on the link between audit committee and corporate performance. They adopted Ex-post facto research design and secondary data was collected from annual reports. Findings revealed a positive but insignificant effect of audit committee independence and expertise on firm performance. Further, they found a positive and significant effect of audit committee meetings on firm performance. Osevwe-Okoroyibo and Emeka-Nwokeji (2021) recommended that a need for a sustained frequencies of audit committee meetings, inclusion of independent non-executive directors and financial expertise be considered as a requirement during the appointment of the audit committee to improve performance of firms.

In 2022, Oduor, Adoyo and Mule anchored their study on Economic Value Added, Agency to assess the effect of audit committee characteristics on the financial performance of deposit taking SACCOs in Western Kenya. The study applied correlational research design, both primary and secondary data was collected. A sample size of 120 respondents was derived through purposive sampling from the SACCO's top management. Secondary data collected using a questionnaire. Findings revealed that audit committee characteristics accounted for 65.1% variance in financial performance and has a strong effect on financial performance. The study pointed out that Saccos should prioritize setting up functional audit committees characterized with independence, financial expertise, diversity, and frequency of meeting to ensure they undertake their mandate effectively and enhance the quality of financial reporting.

Henry, Duncan, and Robert (2022) sought to determine the effects of audit committee characteristics on internal audit effectiveness in the devolved units in Kenya. This study was underpinned on Stakeholders Theory, the Agency Theory, and Institutional Theory. The study was undertaken to underscore the importance of having an effective auditing committee to address governance issues. Further, the study aimed at addressing lack of stringent adherence to the corporate governance practices (Henry, Duncan, and Robert, 2022). Study findings reveal that audit committee size, and its independence had a positive significant relationship. Henry, Duncan, and Robert (2022) recommend proper composition of audit committee with well spelt out terms to enable their functions effectively.

METHODOLOGY

This study adopted a descriptive cross-sectional survey, which was considered the most suitable for achieving the research objective. In addition, due to the investigative nature of this study, correlational research design was used to test the study hypothesis. A sample size of 108 Saccos was drawn from 150 eligible Saccos using the Hyper-geometric distribution in accordance with Krejcie and Morgan (1970) table of determining the sample size. Random and stratified sampling were adopted. Primary data was collected using a semi structured questionnaire. The questionnaire piloted to 11 respondents were identified through random sample. Cronbach's Alpha was used to measure the common internal consistency. Data was analysed using both descriptive and inferential statistic. The results of the statistical analysis were presented using charts, tables, frequencies, and bar graphs.

RESULTS AND DISCUSSION

This section presents the results and discussion of the analysis of the primary data of the sampled Saccos in Kenya. The descriptive statistics, correlation and regression analysis are presented below.

Descriptive Statistical Analysis

Table 1: Audit Committee Characteristics and Performance

	M	SD
Composite Mean and Composite Standard deviation	**3.53**	**1.018**

Table 1 reveals that the composite mean and composite standard deviation of audit committee was 3.53 and 1.018 respectively. This implies that audit committee characteristics to a greater extent influenced the performance. Particularly, the study found that internal audit recommendations when implemented within a greed timeline contributes favorably to audit committee operations. The result supports the finding by Kyereboah-Coleman (2007), Saat *et al*. (2012) and Munene, Njangiru and Ngungu (2016) who observed that independent audit committee enhances performance positively. Independent audit committee ensures an objective review of company activities (Munene *et al.*, 2016). The result support findings by Al-Rassas and Kamardin (2015) who observed that the independence of audit committee ensures that their oversight duty is professionally and responsibly undertaken. However, studies by Kamau, Machuki and Aosa (2018) and Ebrahim et al. (2014) found that audit committee independence was statistically not significant in predicting firm performance.

Another important aspect of study specialization. Generally, financial knowledge and skills enhance the capability of audit committee to comprehend and perform financial oversight duties effectively. Further, Financial reporting quality and monitoring is better when financial experts are incorporated in the audit committee. Financial knowledge provides a good basis for examining and analysing financial information. This implies that the board leadership should ensure financial reporting is done as per agreed timelines. A lengthy tenure service might not compromise audit committee directors' independence. Effectiveness is enhanced when each audit committee member's terms of engagement are clearly defined. If the tenure of Audit Committee members is too short, it is difficult to make meaningful contribution to the success of the organization. The result support the findings by Cheng and Groysberg (2020) who pointed out that while adopting policies on tenure limits, organizations should be cognizant of preserving the valuable knowledge held by longtime audit committee members to safeguard its independence to influence positively their performance.

Correlation Analysis

Table 2: Correlation Analysis of Audit Committee and Performance

		Performance
Audit Committee	Pearson Correlation	0.144
	Sig. (2-tailed)	0.143
	n	105

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

The correlation results from Table 2 shows that the correlation coefficient based on the various constructs of audit committee was found to be 0.143 with a *P-value* of 0.143>0.05. The implication of the finding to this study is that there is no significant relationship between audit committee and performance of deposit taking SACCOs in Kenya leading to no rejection of the null hypothesis because the *p-value* of 0.143>0.05.

Regression Analysis

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.144[a]	0.021	0.011	0.55921

a. Predictors: (Constant), Audit Committee

Table 3 shows that the coefficient of determination (R-square) of 0.021 indicated that the model explained only 2.1% of variance in Performance, while the remaining 97.9% is explained by the other factors outside this model. Adjustment of the R square did not change the results substantially, having reduced the explanatory behavior of the predictor to 1.1%. From the Model summary in Table 3, there is a weak positive correlation of R = 0.144 between Audit Committee and Performance.

Table 4: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.680	1	0.680	2.174	0.143[b]
	Residual	32.210	103	0.313		
	Total	32.890	104			

a. Dependent Variable: Performance of deposit taking SACCOs in Kenya.
b. Predictors: (Constant), Audit Committee

The results from Table 4 show that regression does not fit the model for the data as $F(1,103) = 2.174$ since *P-value* = 0.143 ($p > 0.05$), indicating that the model is not statistically significant in explaining the extent to which audit committee influences performance.

Table 5: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.215	0.397		8.107	0.000
	Audit Committee	0.164	0.111	0.144	1.474	0.143

a. Dependent Variable: Performance of deposit taking SACCOs
b. Predictors: (Constant), Audit Committee

Table 5 shows that only the coefficient of the constant term ($\beta = 3.215$; $p < 0.05$) was statistically significant with the coefficient of Audit Committee having *P-value* = 0.143 ($p > 0.05$) not statistically significant. With regards to audit committee, a unit increase on it, results into in significant increase in performance by 0.164 ($p = 0.143 > 0.05$). The result supports findings by Ebere, Eal and Ogbonna (2016), Kipkoech and Rono (2016), Zraiq and Fadzil (2018) and Bouaine and Hrichi (2019) who found that establishment of audit committee had a positive but insignificant relationship with performance. However, the study finding differs with prior studies by Kyereboah-Coleman (2007), Hamdan *et al.* (2013), Ebrahim *et al.* (2014), Aldamen *et al.* (2012), Munene et al. (2016) and Oduor, Adoyo and Mule (2022) who found positive relation with statistically significant between audit committee characteristics and performance. However, Idris *et al.* (2013), Al-Matar, Al-Swidi and Fadzi (2014) and Nuhu, Suleiman, and Sani (2017) reported mixed results with Idris *et al.* (2013) concluding that effective audit committee result in higher performance. Oduor, Adoyo and Mule (2022) concluded that audit committee characteristics are a good predictor of performance.

CONCLUSION

The study sought to assess the effect of Audit Committee characteristics on performance of Deposit Taking SACCOs in Kenya. Results illustrated a weak positive correlation between audit committee and performance of deposit taking Saccos in Kenya. However, this was not statistically significant. A review of previous studies revealed a mix of inconclusive findings. Nevertheless, establishment of audit committee remains an important process to safeguard stakeholders' interests. What seems to be in contention is the functionality and operationalization of this important player in the governance mechanisms. The study recommends proper constitution of audit committee with well spelt out terms of service and a consideration be made on appropriate study specialization. Independence of audit committee must be complied with to ensure conformity to best standards of practice. The study contributes to a general body of knowledge on further development of agency theory particularly in controlling of managerial behavior to ensure the interests of shareholders are protected. The study highlights considerations in the constitution of boards, audit committee and appointment of executives as an important aspect on decision making process, innovation, monitoring, supervisory and advisory roles that will lead to improved performance. The finding supports the agency theory in terms of controlling managerial behavior that the management do not dominate the board and ensuring the interests of shareholders are protected, hence influencing performance. Areas for further studies suggested are conducting studies in other contexts to corroborate these findings and consideration of other variables of Audit Committee characteristics on their effect on performance.

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