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Thematic Area, Accounting and Taxation Relationship between Audit Committee Independence and Earnings Quality of Non- Financial Firms Listed at the Nairobi Stock Exchange, Kenya

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Abstract:

Specifically, the study sought to determine the relationship between audit committee independence and the earnings quality of non-financial companies listed on the Nairobi Stock Exchange (NSE), as well as the effect of audit committee independence on earnings quality when ownership concentration is taken into consideration as a moderator of the relationship. The study followed a positivist research philosophy and employed a quantitative research design. The study's target population was the 39 non-financial companies listed on the NSE as of December 31, 2020. The study made extensive use of secondary data. For 13 years, information was gathered via a disclosure index (2008-2020). After running diagnostic and specification tests on the model under test, a panel regression model was used to analyze the data. The audit committee independence of non-financial enterprises listed on the NSE had a significant impact on the earnings quality of the companies in both the presence and absence of ownership concentration as a moderator, according to the findings. Additionally, the results revealed that the model that included a moderator outperformed the model that did not include a moderator (ownership concentration). The study comes to the conclusion that the independence of the audit committees of non-financial companies listed on the NSE has a significant impact on the quality of their earnings. Non-financial companies listed on the NSE, according to the findings, should evaluate the criteria used to determine the composition of their audit committees in order to ensure that they are more independent and diverse. This will eliminate earnings manipulations while also making directors more accountable to shareholders, thereby increasing investor confidence in the company.

Keywords: Audit committee independence, Earnings quality, Non-financial firms

1. Introduction

Global corporate governance regulations place a strong emphasis on the independence of auditors and directors, with the expectation that this will improve protection for both shareholders and stakeholders (Ianniello, 2015). As an important part of corporate governance, the Audit Committee provides the board of directors with professional evaluations of top management actions, risk management, financial reporting quality, and internal audit. It also serves as a resource for board members. It communicates with external auditors on the board's behalf and ensures that the recommendations of external auditors are implemented. An internal control or internal audit department is a critical component of ensuring good corporate governance and is therefore required. Therefore, the audit committee is required in order to ensure that the bank's assets are protected and that good corporate governance principles are adhered to (Njanike et al., 2011).

Audit committee independence has been a major global concern in corporate governance over the last decade (Tricker & Tricker, 2015), as it is the oversight mechanism that determines firms' financial performance as measured by reported earnings quality. According to Hermawan and Adinda (2012), the existence of an Audit Committee had no discernible effect on the quality of earnings. Klein (2002) discovered a negative correlation between audit committee independence and the quality of accruals, as well as an increase in erroneous accruals when the committee size was reduced. Anderson et al. (2004) discovered a correlation between audit committee independence and lower debt financing costs, but not between yield spreads and committee size.

According to Adewumi et al. (2019), internal auditing is critical for ensuring sound corporate governance. Their study found that having useful internal audit functions as part of an internal control management system increases efficiency and effectiveness, reduces information asymmetry during decision making, and ensures internal financial

reporting process reliability. Musyoka (2015) discovered that audit committee independence has a detrimental effect on earnings management at Nairobi Securities Exchange-listed companies.

Earnings quality accurately reflects a company's current operating performance and acts as a predictor of future operating performance, making it a valuable metric for determining a company's value (Dechow & Schrand, 2004). Earnings are not created equal. Earnings quality is determined by the earnings composition, the stage of the business's life cycle, and the time period (Dechow & Schrand, 2004).

The cash flow structure is highly influenced by the business's operations structure, which determines financial reporting characteristics such as the portrayal of accruals quality as a measure of earning quality. Discretionary and inherent accruals are the two subcomponents of earnings. The Deschow and Dichev (2002), McNichols (2002) and Francis et al. (2005) school of thought on accruals quality has largely been the consensus in the accrual's quality literature. The mapping of working capital accruals into cash flows over time is captured by McNichols's (2002) measure of accruals quality. Discretionary accruals are a type of accounting that involves manipulating accruals to control earnings and represent a result that differs from an organization's true financial status.

Prior research has employed accrual methods to capture quality in reported earnings. Several academics have used accruals to quantify earnings quality using these measures. Jones utilized a typical approach in 1991, dividing accruals into normal and abnormal categories based on a total accrual forecast model. Other approaches have been employed to identify earnings management or discretionary accruals by researchers.

Foreign ownership has also been shown to have a moderating effect on the relationship between corporate governance and earnings quality when it comes to ownership concentration (Liu, Saidi & Bazaz, 2014). Businesses with a high degree of foreign ownership are regarded to have effective corporate governance, according to Bhaumik & Selarka, (2012). Foreign ownership is related with less opportunistic earnings manipulations, according to Jiang and Kim (2004), while government ownership presents comparable reasoning.

Ramsey & Blair (1993) reveal that a firm with a bigger ownership concentration tends to attract a large number of shareholders who have adequate incentives that are needed to control the financial managers. Also, Demsetz and Lehn (1985) and Stiglitz (2005) claim that shareholders that form the block-based management must agree on the fixed costs they should bear if they are to engage in the effective management of finances. However, Maher and Andersson (2002) are skeptical about block management and they argue that it leads to distributed ownership, which weakens the incentive to monitor the management.

Despite extensive scholarly research on the relationship between audit committee independence, earning quality, and ownership concentration, the challenge persists because little is known about the impact of audit committee independence on earnings in the presence and absence of ownership concentration as a moderating factor for firms listed on the Nairobi Securities Exchange (Kenya), necessitating additional research in this area as even existing research is inconclusive.

1.1. Statement of the Problem and Study Objectives

Inadequate management monitoring and control, where audit independence is critical, may result in accounting fraud as a result of misplaced policies, as witnessed globally over the last decades. The issue is most acute in instances where management is compensated on the basis of results and where contracts bind institutions.

As the audit committee is a critical component of the board where all financial reporting decisions are made, including those regarding disclosures, its composition is critical in independently advising the board and ensuring that accurate disclosures are made in financial statements to enable prudent investors to allocate their resources appropriately.

Across the globe, empirical research on the effect of ownership concentration as a moderator of audit committee independence and earnings quality is inconclusive. Similarly, the Kenyan situation is consistent with what has been observed globally, as research on the relationship between audit committee independence and earnings quality for firms listed on the Nairobi securities exchange has remained inconclusive, resulting in a knowledge gap that this study seeks to fill by employing an uncommon moderator, ownership concentration.

1.2. Study Objective

The study's goal was to look into the link between audit committee independence and earnings quality of non-financial companies listed on the NSE. Ownership concentration was used as a moderator in the analysis.

1.3. Research Hypotheses

- H01 the independence of audit committees has no significant effect on the earnings quality of non-financial companies listed on the NSE.
- H02 Ownership concentration has no moderating effect on the relationship between audit committee independence and earnings quality among non-financial firms listed on the NSE.

2. Literature Review

The study drew on theories developed by a variety of thinkers to address issues of governance, most notably Nasution et al.'s Accounting Theory (PAT) (2020). This provides an explanation for a process that entails the ability to comprehend accounting treatment in various areas of accounting and the adoption of accounting policies that affect financial reporting quality by causing earnings to exceed computed earnings. Earnings computations guided by positive

accounting theory are guided by three hypotheses: the debt covenant hypothesis, the bonus plan hypothesis, in which directors favor policies that increase current earnings, and the political cost hypothesis.

Jensen and Meckling (1976) proposed an agency theory to resolve conflicting interests between management and shareholders. The theory is used to explain the policies pursued by agents in the pursuit of wealth maximization, which entails primarily choosing the best policies that result in accurate reporting of earnings by avoiding unrealistic accruals. Davis et al. (2010) proposes the Resource Dependence Theory to explain how non-executive board members can aid the firm in acquiring necessary knowledge and expertise, thus legitimizing the board's decisions. The theory was used to demonstrate how governance structures can be built on top of existing ownership structures, maximizing the effectiveness of board resources. The Stakeholder theory was developed by Colbert, Wheeler, & Freeman (2003), which requires stakeholders' interests should be considered when the board makes decisions (Manville & Ober, 2003; White, 2009)

The proponents of signaling theory are Leland and Pyle (1977); Myers and Majluf (1984), argue that due to information asymmetry, firms acquire targets via equity if they believe the targets' shares are overvalued, but prefer cash offers if they believe the targets' shares are undervalued. According to the Signaling Theory, the mode of payment serves as a signaling device about the acquired firm's stock value, with cash offers interpreted as positive news and equity offers as negative news. The directors' proposal to increase the dividend will convey information about the firm's current performance, future cash flow expectations, and expected future value. This would be the basis for investors' investment decisions. If earnings quality does not reflect the firm's correct state as a result of an ineffective board, investors' decisions are influenced by inaccurate information. The weakness of Signaling Theory is that it presupposes that director have a monopoly on investment information, while investors have limited access to it. The theory makes no provision for situations in which investors can obtain information about firms from other sources.

Oliveras and Amat (2007) discovered that firms preferred to report a consistent trend of profit growth over a series of ups and downs. This would be accomplished by making excessive provisions for liabilities against asset values in good years in order to reduce these provisions in bad years, thereby improving reported profits. This theory was developed to combat short-termism, which involves valuing an investment solely on the basis of the yield achieved in subsequent years, and to avoid inflating expectations so much in good years that the firm is unable to deliver on later expectations. Investors and shareholders have a right to know when a company's business conditions are turbulent, and income smoothing may obscure long-term changes in profit trends. As a result of creative accounting, a need for awareness of the potential for accounting policy abuse and transaction manipulation has arisen.

Accounting established a framework for tracking contracts between managers and shareholders, evaluating the viability of accounting policies, and reflecting the business's long-term viability. is critical in the preparation and presentation of financial reports, as it requires reports that are in the best interests of shareholders and investors. As a result, management would always be required to adhere to the highest ethical standards (Oliveras & Amat, 2007).

2.1. Conceptual Framework

Conceptual framework is pictorial representation of actualization of relationship between the study variables that is independent variables and dependent variable as described by Ravitch and Riggan (2016). In this, study the relationship between audit committee independence and earnings quality with Ownership concentration as a moderator is presented in figure 1.

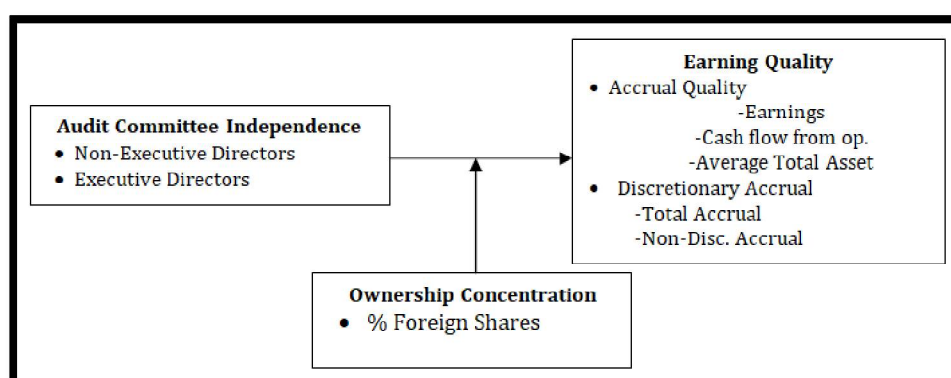


Figure 1: Conceptual Framework

2.2. Audit Committee Independence and Earning Quality

Khalil and Ozkan (2016) discovered that the effect of board independence on earnings management was dependent on the ownership structure between shareholders and executive directors and that an increase in non-executive members on both the audit committee and the board was not always necessary. According to the study, high-quality auditors were also found to be beneficial in minimizing earnings management. According to Fodio et al. (2013), audit committee size has a beneficial effect on discretionary accruals.

According to Hamdan and Mushtaha (2011), the size of audit committees always has an effect on the report prepared by external auditors, but the tendency of audit committee members to take ownership tends to reduce the quality of an external auditor's report. According to Stewart and Munro (2007), establishing an audit committee helps to significantly reduce audit risk. Additionally, there was increased trust in external audits as the risk of bias was eliminated.

According to a 2003 Australian Securities Exchange audit committee requirement study, audit committees were responsible for reducing fraud (Baxter & Cotter, 2009). Additionally, the study discovered that accounting proficiency and the presence of an audit committee had no effect on profitability quality indicators. According to a study on Jordanian firms based on a sample of 50 industrial companies listed on the Amman Stock Exchange (Hamdan, Mushtaha, Al-Sartawi, & Abdalmuttaleb, 2013), the audit committee had an effect on earnings quality.

In their research, Mwangi et al. (2017) discovered that the independence of the audit committee had a beneficial effect on the financial reporting process. Additionally, the study discovered that audit committee diversity resulted in a significant improvement in the quality of financial reporting due to a diversity of problem-solving abilities. The same study discovered that when audit committees were allowed to operate independently, be diverse, and hold high-quality meetings, they demonstrated a high level of competence.

Hamid, Othman, and Rahim (2015) established in their study that an audit committee can adhere to established requirements but still fall short of disclosure requirements. Rahim, Johari, and Takrll (2015) noted in their study that the new requirements raised the prospect of firms improving their financial reporting to the benefit of users through increased transparency and integrity.

Hutchinson, Percy, and Erkurtoglu (2008) in their study found that board and audit committee independence are linked to lower performance-adjusted discretionary accruals, a common measure of earnings management. However, increasing executive shareholdings encourages profit management. Marzuki, Wahab, and Haron (2016) discovered that implementing the revised Malaysian Code on Corporate Governance increased earnings conservatism, while audit committee financial expertise and independence had a significant positive effect on earnings conservatism.

Both Siagian & Tresnaningsih (2011) discovered that once enterprises integrated independent directors and audit committees, both discretionary accrual and earnings response coefficients significantly improved. As per the study outside directors with a high-profile background, such as politicians and lawyers, have a negative correlation with earnings quality. Baatour et al. (2017) in their concluded that multiple directorships have a positive effect on accrual-based and actual earnings management in Saudi Arabia but have a negligible effect on discretionary accrual.

According to Rashid et al. (2010), outside directors may not add significant value to a firm's financial performance in Bangladesh, though their presence may result in increased openness.

The empirical studies evaluated are inconclusive regarding the effect of audit committees on corporate performance, whether in terms of performance or financial reporting, creating a knowledge gap that requires further research. These studies did not examine the effect of audit committee independence on the earnings quality of non-financial companies listed on the Nairobi Securities Exchange, which was a primary objective of the study.

2.3. Ownership Concentration and Earnings Quality

Insider managerial, institutional, external blockholder, family and foreign ownership has the potential to reduce earnings management and increase financial reporting quality, according to the analysis of ownership structure. This research reveals the importance of Jordanian company ownership as a good corporate governance mechanism (Alzoubi, 2016). Ali & Isa (2018) (2018) in their study indicated that companies with a higher proportion of directors' equity shares disclosed significantly less information due to the 'super owner syndrome,' which dictates the firm's every do's and don'ts, whereas companies with the government as a significant shareholder disclosed significantly more information.

Mang'Unyi (2011) examined the relationship between bank ownership structure and value in Kenya and discovered that there was no statistically significant correlation between bank ownership concentration and financial performance. According to Reyna (2018), there is a clear correlation between increased engagement of family and institutional investors and a decline in earnings management. This is consistent with the literature, which demonstrates that increased oversight and participation in management is an effective regulatory mechanism for limiting earnings management. A decrease in earnings management is the result of a greater commitment on the part of these investors who have a longer-term perspective on the firm, which is consistent with agency theory's convergence hypothesis. The fact that indebtedness level and firm size have a positive relationship with earnings management demonstrates the critical role of family and institutional shareholders in influencing discretionary management behavior regarding the presentation of financial information to the investor market.

According to Alzoubi (2016)'s sample of 62 companies listed on the Amman Stock Exchange, insider managerial ownership, institutional ownership, external block holders, family ownership, and foreign ownership all have a greater impact on financial reporting quality.

According to the study, non-managing shareholders in private enterprises face significant agency costs, particularly where management ownership is low or very high. When rational investors anticipate the future impact of agency costs, they may choose to avoid investing in these companies or reduce their valuation to account for the anticipated costs of agency conflicts. The finding that discretionary accruals increase with managerial ownership may be particularly concerning for new shareholders, who are less likely than existing shareholders to be integrated into the 'insider access' model, in which information flows from private companies to shareholders (Ball & Shivakumar, 2005). Due to the increased likelihood that external investors will rely on financial reports to supervise a business, agency costs resulting from misaligned incentives and managerial entrenchment may restrict access to external capital while also increasing the cost of that capital.

Ongore and K'Obonyo (2011) examined the relationships between ownership, board, and manager characteristics and business performance in a sample of 54 firms listed on the Nairobi Stock Exchange (NSE). Using PPMC, Logistic Regression, and Stepwise Regression, the research demonstrates a significant positive correlation between foreign, insider, institutional, and diverse ownership forms and business performance. However, a significant negative relationship

existed between ownership concentration and both government and corporate performance. Due to a lack of adherence to board member selection criteria, the board member selection process was deemed ineffective. Additionally, the findings indicate that management discretionary has a significant positive correlation with performance. These findings are consistent with relevant literature regarding the effects of government, foreign, management (insider), and institutional ownership on firm performance, but they are significantly different regarding the effects of ownership concentration and diversity on firm performance.

These studies did not examine the moderating effect of ownership concentration on the earnings quality of non-financial enterprises listed on the Nairobi Securities Exchange

2.4. Critique of Reviewed Literature

The research reviewed indicates that the influence of audit committee independence on earnings quality as well as the moderating effect of ownership concentration remains mixed, with some studies demonstrating a negative relationship and others demonstrating a positive relationship, implying that the topic is not conclusive. Khalil and Ozkan (2016) concluded that quality auditors can help reduce earnings management.

Hamid, Othman, and Rahim (2015) found that an audit committee can meet established requirements but not meet disclosure requirements. Outside directors may not add significant value to a firm's financial performance in Bangladesh, but their presence may increase openness, say Rashid et al. A significant negative relationship was found between managerial ownership and voluntary disclosure levels. According to Hermawan and Adinda (2012), an Audit Committee had no effect on earnings quality.

According to Ali and Muhammad (2018), companies with a higher proportion of directors' equity shares disclosed less information. Mang'Unyi (2011) found no statistically significant correlation between ownership structure and financial performance. All of these types of ownership have a greater impact on financial reporting quality according to Alzoubi (2014). Ongore and K'Obonyo (2011) notes a significant negative relationship existed between ownership concentration on both government and corporate performance.

2.5. Research Gaps

According to the findings of the empirical evaluation, this study sought to address a variety of research gaps. The current study examined the effect of audit committee independence on the earnings quality of companies listed on the Nairobi Securities Exchange, a market where earnings quality is becoming increasingly important. The current study examined the independence of audit committees on boards of directors and the quality of their earnings, a research gap. The majority of the research reviewed did not examine gender as a source of variation in Kenya's securities market, as this study did. The empirical studies evaluated did not examine the CEO duality proxy's effect on the earning quality of non-financial enterprises listed on the NSE. Because empirical reviews did not examine the moderating effect of ownership concentration on earnings quality, we exploited this knowledge gap by examining the moderating effect of ownership concentration on the relationship between board composition and earnings quality.

3. Methodology

The research reviewed indicates that the influence of board composition on profit quality remains mixed, with some studies demonstrating a negative relationship and others demonstrating a positive relationship, implying that the topic is not conclusive. Bowen, Rajgopal, and Venkatachalam (2008) discovered a positive relationship between board composition and structure and profit quality in a variety of contexts, including the United States of America, using panel data from firms listed on the New York Stock Exchange. Bushman, Chen, Engel, and Smith (2004) established a negative relationship between board composition and structure and earnings quality using ordinary least squares regression analysis on data from publicly traded Chinese firms. LaFond and Roychowdhury (2008) examined firms in the United Kingdom using panel regression and discovered a negative relationship. Bushman, Chen, Engel, and Smith (2004) discovered a negative relationship using ordinary least squares regression analysis on data from publicly traded Chinese firms. The effect of major board composition factors on the earning quality of non-financial enterprises listed on the NSE, such as board size, board diversity, audit committee independence, and CEO duality, has not been examined in the reviewed empirical research, necessitating this study. Additionally, the empirical literature reviewed did not examine the moderating effect of ownership concentration on the relationship between board composition and earnings quality of companies listed on the Nairobi Securities Exchange.

3.1. Model Specification

Panel regression model was applied for the study where 33 sampling units (non-financial firms) for a period of thirteen years was adopted. Moderating effect of ownership concentration was also considered. The model was as follows:

$$Y_{it} = \beta_0 + \beta_1 x_{1it} + \varepsilon_{it} \quad 1$$

Moderating effect of ownership concentration was also considered and this led to the following model

$$Y_{it} = \beta_0 + \beta_1 x_{1it} + \theta_1 x_{1it} * z + \varepsilon_{it} \quad 2$$

where: Y_{it} is the Earnings Quality, x_1 is Audit committee independence, β_0 is the intercept β_1 is the coefficient of the explanatory variable (audit committee independence), θ_1 is the coefficients of the moderator variable (ownership

concentration), Z is the moderator (ownership concentration), ε_{it} is an error term $i = 1, 2, 3, \dots, 33$ firms listed in NSE and t is the time in years from the year 2008 to 2020.

Audit committee independence as the independent variable was the proportion of non executive members included in the audit committee. Accrual quality (AQ) and Discretionary accrual (DA) were the main measurement units for the dependant variable (earnings quality) based on modified Jones model (1991) approach where the proxy of accrual quality was based on the metric ratio for the absolute value of abnormal accruals given by:

$$AQ = |AA_{j,t}| \quad 3$$

$$\text{where } AA_{j,t} = \frac{TA_{j,t}}{Assets_{j,t-1}} - NA_{j,t}$$

and

$$NA_{j,t} = \hat{\phi}_1 \left(\frac{1}{Asset_{j,t-1}} \right) + \hat{\phi}_2 \left(\frac{\Delta REV_{j,t} - \Delta REC_{j,t}}{Assets_{j,t-1}} \right) + \hat{\phi}_3 \left(\frac{PPE_{j,t}}{Assets_{t-1}} \right) + \varepsilon_{j,t}$$

$$\frac{TA_{j,t}}{Assets_{j,t-1}} = \phi_1 \left(\frac{1}{Asset_{j,t}} \right) + \phi_2 \left(\frac{\Delta REV_{j,t}}{Assets_t} \right) + \phi_3 \left(\frac{PPE_t}{Assets_t} \right) + \varepsilon_t$$

low values of $|AA_{j,t}|$ suggest better accruals quality while large values $|AA_{j,t}|$ suggest poor accrual quality.

The discretionary accruals (DA) were computed using non-discretionary accrual (NDA_{jt}) and total accruals at time t (TA_{jt}) given as:

$$DA = TA_{j,t} - NDA_{j,t} \quad 5$$

With Non-discretionary accrual (NDA_{jt}) and total accruals at time t (TA_{jt}) expressed as:

$$NDA_{jt} = \phi_1 \left(\frac{1}{Asset_{j,t}} \right) + \phi_2 \left(\frac{\Delta REV_{j,t} - \Delta REC_{j,t}}{Assets_{j,t}} \right) + \phi_3 \left(\frac{\Delta PPE_{j,t}}{Assets_{j,t}} \right) + \varepsilon_{j,t}$$

and

$$TA_{jt} = (\Delta CA_{jt} - \Delta Cash_{jt}) - (\Delta CL_{jt} - \Delta STD_{jt} - \Delta TP_{jt}) - DEP_{jt}$$

where ΔREV_t = is revenues in year t less revenue in year $t-1$, ΔREC_t = is net receivables in year t less net receivable in year $t-1$, ΔPPE_t = is gross property plant and equipment in year t less gross property plant and equipment in year $t-1$, $Assets_{t-1}$ = is total assets at the end of year $t-1$, ϕ_1 , ϕ_2 and ϕ_3 are firm-specific parameters, ΔCA = is Current Assets in year t less current assets in year $t-1$, $\Delta Cash$ = is the cash / Cash equivalents in year t less cash / Cash equivalents in year $t-1$, ΔCL = is the Current Liabilities in year t less current liabilities in year $t-1$, ΔSTD = is Short-term Debts in year t less short-term debts in year $t-1$, ΔTP = is Income Taxes Payables in year t less Income Taxes Payables in year $t-1$, DEP = Depreciation and Amortization expense.

To certain the suitability of the proposed model for the data, several diagnostic test statistics such as: Panel cointegration test, Stationarity test using unit root test, heteroscedasticity test, outlier test and autocorrelation were conducted. Hausman specification tests of the model were also performed mainly to decide the most optimal model between fixed and random effects model of panel regression.

4. Research Findings and Discussion

Again, examining the percentage mean and median growth for audit independence within the firms for 13 years as indicated on table 4.3, the lowest and the highest mean for audit independence was 76.4958 and 78.8314 respectively. These values suggest that auditors within firms were independent but a significant gap needs to be bridged for 90% and above audit autonomy to be achieved within firms listed in Nairobi Securities Exchange. The outcome of the analysis suggests that the mean percentage remained fairly constant over the years, however, a slight drop in the percentage mean of audit independence was observed. On the other hand, the highest percentage median value for firms across the years was 85.7143 recorded in the last three years, with corresponding positive median growth of 3.8961 while the lowest percentage median value was 81.8182 with the corresponding negative decline in median growth of -1.5152. In general, some firms exhibited a declining trend as far as audit independence is concerned, others remained constant, and a few firms exhibited the recorded apposite but small growth in audit independence. Despite the range of 76.4958% and 78.8314% respectively for audit independence over the years for firms listed in Nairobi stock exchange, it was noted that the findings were in agreement with those of Al-Rassas and Kamardin (2015) who found out that audit committee members independence was within the range of the 67% minimum and a maximum of 100%.

Year	Mean	Median	Increase/Decline in Mean	Increase/Decline in Median
2008	78.2034	83.3333	-	-
2009	78.4291	83.3333	0.2257	0.0000
2010	78.8314	83.3333	0.4022	0.0000
2011	77.8918	83.3333	-0.9396	0.0000
2012	77.8919	83.3333	0.0001	0.0000
2013	78.0829	81.8182	0.1910	-1.5152
2014	78.6568	81.8182	0.5739	0.0000
2015	78.4043	81.8182	-0.2525	0.0000
2016	76.4958	85.7143	-1.9085	3.8961
2017	77.7209	85.7143	1.2251	0.0000
2018	78.7900	85.7143	1.0690	0.0000
2019	75.8628	85.7143	-2.9272	0.0000
2020	75.8628	85.7143	0.0000	0.0000

Table 1: Mean, Median for Audit Independence across the Years

The overall mean of Audit Independence for 33 firms was 78.218 with the Maximum percentage of audit independence recorded was 100% corresponding to Nation Media Group Ltd and Carbacid Investments Plc. Also, the minimum percentage of audit independence recorded was 25% corresponding to Limuru Tea Co. Ltd. It was observed that firms with a high percentage also recorded high values growth in terms of profitability and the general growth of the company. Table 2 in appendix 1 gives the details of the finding. In most cases, audit independence is considered as one of the best practices in realizing company laid out objectives. Audit independence makes it possible for the firms to evaluate their past performance and make necessary adjustments towards improvement since it promotes accountability and transparency which are key ingredients for growth. As per individual firms, the output of the study findings was not in agreement with those Al-Rassas and Kamardin (2015) since 33% to 100% values of audit independence were recorded as the lowest value and highest value respectively. On average audit, independence was also below 84% recorded by (Madi, Ishak & Manaf, 2014).

Considering audit independence per sector, it was established that firms that are linked with telecommunication and technology were the best since they recorded the highest mean for audit independence at 89.00%. This was followed by firms categorized as Manufacturing firms 79.1697%. Commercial Service Industry was ranked 3 with a percentage mean of 78.9697%, firms listed in NSE under Energy and Petroleum were ranked 4 with an overall mean score of audit independence of 75.6667%. The fifth place was taken by firms listed under the agricultural sector with audit independence. 74.6909% was for manufacturing firms, 74.4546% was for Automobile Industry, and lastly, the construction allied industry sector recorded the least average audit independence at 72.3091%. The findings again demonstrated how firms listed under the construction allied sector perform dismally compared with firms listed under telecommunication. From the results, it can be noticed that firms characterized high mean score of audit independence are likely to perform better thus enhancing earning quality. Figure 4.3 shows the details of the finding.

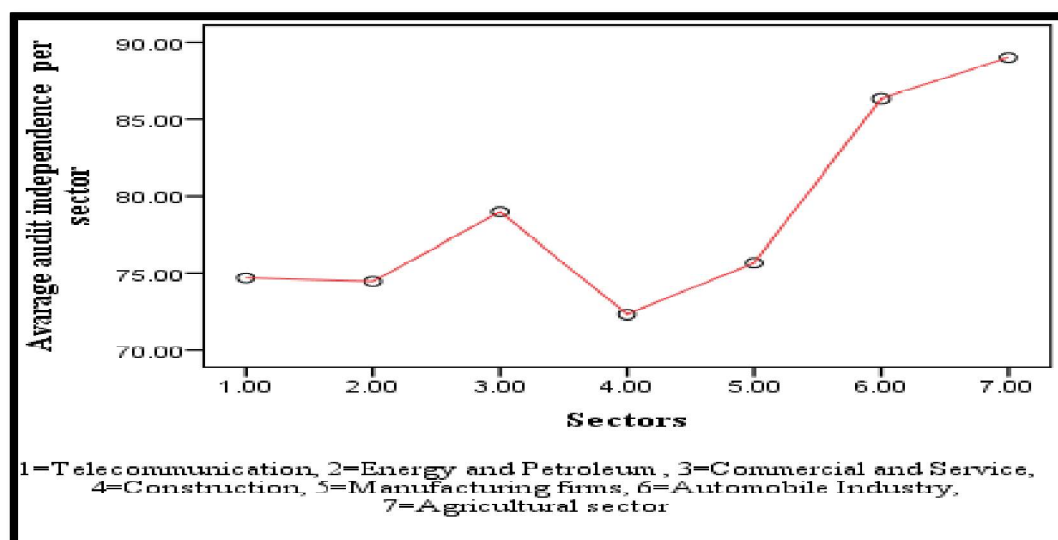


Figure 2 Average Audit Committee Independence Per Sector

4.1. Draft Regression

To determine the relationship between Audit Committee independence and the level of earnings quality of non-financial firms listed on the Nairobi Securities Exchange, statistical inference based on panel regression analysis was used.

According to the findings, which are summarized in Table 2, the relationship between earnings quality of non-financial firms listed on the NSE and Audit Committee independence was established. Three types of panel regression models were run using accrual quality and discretionary accrual as the only measures to the dependent variable earnings quality of non-financial firms listed on the NSE, namely Pooled OLS, Randomized, and Fixed models. The results of this research were put through a series of tests to determine the accuracy of the models that were fitted. In this regard, the outputs based on table 2 showed R-square values of 0.459, 0.288, and 0.701, respectively, indicating the extent to which audit committee independence explains the variation in the dependent variable. In this study, it was discovered that in the absence of a moderator, Audit Committee independence explained 45.9%, 28.8%, and 70.1 percent of accrual quality, respectively. Furthermore, it was discovered that in the presence of a moderator (ownership concentration), published R-square values were lower; 0.503, 0.313, 0.715 showing that 50.3%, 31.3%, and 71.5% of the total variation in quality accrual of non-financial firms listed at the NSE were explained by Audit Committee independence without the moderator.

Further analysis, as shown in table 3, reveals that the published R-square values for discretionary accrual were 0.6390, 0.4385, and 0.826, indicating that there was a strong relationship between discretionary accrual and Audit Committee independence. In particular, audit Committee independence without ownership concentration was found to predict 63.9 percent, 43.9 percent, and 82.6 percent of discretionary accrual of earnings quality for non-financial firms listed on the NSE (moderator). The moderator's inclusion in the model also results in R-square values of 0.6398, 0.4374, and 0.8763. Again, the results indicate that the models improved significantly when moderators were present. In this scenario, 63.98 percent, 43.74 percent, and 87.63 percent of discretionary accrual of earnings quality for non-financial corporations listed at the NSE were predicted by Audit Committee independence in the presence of moderator Besides. Besides that, the fitness of the models was also elaborated by F-statistics values 306.85, 145.91, and 23.381 with the corresponding p-values of 0.010 0.0301 and 0.000 when a moderator is absent and 580.6 256.1 and 63.57 with a p-value of 0.000 0.000 and 0.001 when the moderator is present the values were all less than 0.05. These data simply point to a link between Audit Committee independence and accrual quality, discretionary accrual, and total profits quality of non-financial enterprises listed on the Nairobi Securities Exchange.

The coefficient estimates for the three-model were investigated, and a t-test was used to test the effect of the predictor variable (Audit Committee independence) on accrual quality and discretionary accrual of total earnings quality of non-financial enterprises listed on the NSE in each case. Two cases were tested in each of the models evaluated, namely when a moderator was present and when a moderator was absent. With P-values less than 0.05 for all models involving no moderator and moderator for both accrual quality and discretionary accrual, it was obvious that Audit Committee independence had a substantial effect on the profits quality of non-financial firms listed on the Nairobi Securities Exchange. The conclusion was that there was some significant influence of Audit Committee independence on accrual quality and discretionary accrual of financial institutional listed in NSE.

The findings of Fodio et al. (2013) showing audit committee independence have a beneficial impact on discretionary accruals are in line with the study's findings. Mwangi (2018) found that audit committee independence had a favorable impact on the financial reporting process, confirming the study's findings. Furthermore, the findings matched those of Kamarudin et al. (2012), who found that independent audit committees are more successful at monitoring the quality of financial statements, and that independent audit committees have a favorable and significant impact on financial performance. Chan and Li (2008) found that having an audit committee increases the value of a company. Guo et al. (2014) also found a link between firm valuation and profitability in East Asian companies. Audit committees failed to deter earnings management practices, according to Wan Mohammad et al. (2016) findings.

The analysis did not accord with SetiaAtmaja (2009) conclusions that ownership concentration hurts board independence but has no effect on audit committee independence in the presence of a moderator. Kamardin and Al-Rassas (2015). The study found that audit committee independence is linked to a high level of profits quality without using ownership concentration as a moderator. However, the study revealed that in the context of ownership concentration, earnings quality was low, which contradicted the findings. The findings of Yang and Krishnan (2005) and Mohamed (2011) found a strong and negative link between audit committee independence and discretionary accruals, but the study contradicted these findings. Similarly, in their publications, Bradbury et al. (2006), Garcia, Barbadillo, and Perez (2012), and Salleh and Haat (2014) show that audit committee independence is linked to improved profits quality. Furthermore, studies (Ahmad-Zaluki & Wan-Hussin, 2010; Bradbury et al., 2006; Siagian & Tresnaningsih, 2011) found a positive relationship between the independent audit committee and earnings quality, with findings that matched study findings.

Dependent Variable: Earnings quality of non-financial firms listed at the Nairobi Stock Exchange (NSE), Quality Accrual,

Method: Panel Least Squares Sample: 2008 2020, Periods included: 13 Cross-sections included: 33 Total panel (balanced) observations: 429

Type of Model	Variable	B	SE	T	P	R ²	Adj R ²	F	P-value
Pooled OLS	C	1.4119	0.167	8.4477	0.0000	0.459	0.458	306.85	0.000
	AUD.I	0.0367	0.002	17.517	0.0000				
	S.E. of regression			0.5938	Akaike info criterion				1.8012
	Sum squared resid			127.32	Schwarz criterion				1.8227
Pooled OLS with moderator	C	2.5674	0.148	17.291	0.0000	0.503	0.499	181.41	0.000
	AUD.I	0.0346	0.002	19.047	0.0000				
	AUD.I*Z	0.0016	0.001	0.1321	0.8950				
	S.E. of regression			0.5133	Akaike info criterion				1.5124
Sum squared resid			94.60	Schwarz criterion				1.5447	
Random Effects Model	C	1.2995	0.257	5.0432	0.0000	0.289	0.286	145.91	0.000
	AUD.I	0.0382	0.003	12.065	0.0000				
	S.E. of regression			0.462	Sum squared resid				77.099
Random Effects with Moderator	C	2.519	0.227	11.118	0.0000	0.313	0.309	81.737	0.000
	AUD.I	0.035	0.003	12.685	0.0000				
	AUD.I*Z	0.0035	0.000	0.1753	0.0098				
	S.E. of regression			0.4665	Sum squared resid				78.11
Fixed effect Model	C	1.212	0.311	3.891	0.0001	0.701	0.671	23.381	0.000
	AUD.I	0.039	0.003	9.906	0.0000				
	S.E. of regression			0.4626	Akaike info criterion				1.385
Sum squared resid			70.42	Schwarz criterion				1.750	
Fixed effect Model with moderator	C	2.4738	0.279	8.8614	0.0000	0.715	0.674	22.982	0.000
	AUD.I	0.0359	0.003	9.831	0.0000				
	AUD.I*Z	0.0046	0.003	1.536	0.0087				
	S.E. of regression			0.414	Akaike info criterion				1.167
Sum squared resid			56.12	Schwarz criterion				1.543	

Table 2: Panel Regression Analysis Results for Audit Committee Independence and Accruals Quality

Dependent Variable: Earnings quality of non-financial firms listed at the Nairobi Stock Exchange (NSE), (Discretionary Accrual)									
Method: Panel Least Squares: Sample: 2008 2020, Periods included: 13 Cross-sections included: 33 Total panel (balanced) observations:									
Type of Model	Variable	B	SE	T	P	R ²	Adj R ²	F	P-value
Pooled OLS	C	-0.873	0.0935	-9.334	0.0000	0.639	0.637	580.6	0.000
	AUD.I	0.0283	0.0012	24.096	0.0000				
	S.E. of regression			0.3182	Akaike info criterion				0.5539
	Sum squared resid			33.216	Schwarz criterion				0.5769
Pooled OLS with moderator	C	-0.855	0.0959	-8.912	0.0000	0.639	0.638	290.4	0.000
	AUD.I	0.0283	0.0012	24.084	0.0000				
	AUD.I*Z	0.0064	0.0007	8.469	0.0398				
	S.E. of regression			0.3184	Akaike info criterion				0.5578
Sum squared resid			33.144	Schwarz criterion				0.5924	
Random Effects Model	C	-0.714	0.1365	-5.233	0.0000	0.438	0.437	256.1	0.0001
	AUD.I	0.0263	0.0016	15.997	0.0000				
	S.E. of regression			0.1959	Sum squared resid				12.598
Random Effects with Moderator	C	-0.706	0.1387	-5.089	0.0000	0.437	0.434	7.78	0.0005
	AUD.I	0.0264	0.0016	15.721	0.0000				
	AUD.I*Z	0.00548	0.0015	3.5584	0.0422				
	S.E. of regression			0.1960	Sum squared resid				12.562
Fixed effect Model	C	-0.652	0.1478	-4.408	0.0000	0.826	0.823	63.57	0.0000
	AUD.I	0.0255	0.0019	13.516	0.0000				
	S.E. of regression			0.1961	Akaike info criterion				-0.323
Sum squared resid			11.379	Schwarz criterion				0.0680	
Fixed effect Model with moderator	C	-0.6509	0.1489	-4.3701	0.0000	0.876	0.862	61.49	0.0000
	AUD.I	0.0255	0.0019	12.807	0.0000				
	AUD.I*Z	0.0010	0.0002	4.322	0.0492				
	S.E. of regression			0.1964	Akaike info criterion				-0.317
Sum squared resid			11.378	Schwarz criterion				0.0855	

Table 3: Panel Regression Analysis Results for Audit Committee Independence and Discretionary Accruals

The Hausman test was used to determine which model was the most appropriate among the randomized and fixed models. The results showed that in the absence of a moderator, the random-effects model was the most appropriate

model, with test statistics values of 0.5569, while in the presence of a moderator, the fixed effect model was the most appropriate model for non-financial institutions listed on the NSE. The results of the Hausman test are detailed in Table 4.

4.2. Hausman Test for Audit Committee Independence

Furthermore, it was found that all of the models were significant, so a Hausman test was used to choose the best suited model among them. The Hausman test is used to determine which model is the most appropriate among fixed models and GLS Randomized models. When compared to Random effects models, the Hausman test statistical result reveals that all fixed effects models with no moderator (ownership concentration) and with moderator were the best suited models. To put it another way, the full null hypotheses for accrual quality of non-financial institutions listed on the NSE were rejected, with p-values of 0.00641 and 0.00951 respectively. The fixed models in the absence of a moderator and the fixed models in the presence of a moderator were both found to be appropriate models for Discretionary accrual. p-values of 0.00375 and 0.00524 were found, respectively.

Model	Correlated Random Effects - Hausman Test. Test. Cross-section Random Effects				
Audit independence Accrual quality with no moderator (Z)	Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
	Cross-section random		0.218622	1	0.00641
	Cross-section random effects test comparisons:				
	Variable	Fixed	Random	Var(Diff.)	Prob.
	AUDIT. I	0.039329	0.038210	0.000006	0.00641
Audit independence Accrual quality with moderator	Cross-section random		0.101831	2	0.00951
	Cross-section random effects test comparisons:				
	Variable	Fixed	Random	Var(Diff.)	Prob.
	AUDIT. I	0.035991	0.035253	0.000006	0.07568
	AUDIT. I*Z	0.034215	0.032124	0.000007	0.08487
Audit independence with DA in the presence of a moderator	Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
	Cross-section random		0.749573	1	0.00375
	Cross-section random effects test comparisons:				
	Variable	Fixed	Random	Var(Diff.)	Prob.
	AUDIT. I	0.025475	0.026274	0.000001	0.00375
Audit I with DA in the presence of a moderator (Z)	Cross-section random		0.691195	2	0.00524
	Cross-section random effects test comparisons:				
	Variable	Fixed	Random	Var(Diff.)	Prob.
	AUDIT. I*Z	0.025502	0.026364	0.000001	0.0422
		0.023651	0.020864	0.000004	0.0803

Table 4: Hausman Test Table for Audit Committee Independence

Hausman test statistics for Audit independence table 4 gives the details of the finding. Among the four models, the most appropriate model for both accrual quality was determined by comparing R²-values. Starting with Accrual quality, the fixed-effect model with the moderator (FM) was the most optimal model represented by R²_{FM}>R²_{FW} (0.715>0.701).

$$QA = 2.474 + 0.03599AUDIT.I + 0.0046037AUDIT.I * Z$$

For discretionary Accrual, again fixed effect model with a moderator was the best model with R²_{FM}>R²_{FW} (0.879>0.826). Based on earning quality, quality accrual and discretionary accrual measures are affected by Audit independence in the presence of a moderator (Ownership concentration).

$$DA = -0.6509 + 0.025502 * AUDIT.I + 0.02254 AUDIT. I * Z$$

5. Conclusion

Because audit committee independence had a considerable impact on financial performance, it may be used to forecast the financial performance of non-financial enterprises on the Nairobi Securities Exchange. The two models, random effects and fixed effects, were used with and without a moderator, and the results showed that audit committee independence had a substantial impact on both return on assets and discretionary accrual (financial performance) of the firms listed at the. The findings also showed that when the moderator was added in the models, the R² increased significantly, demonstrating the effect of the moderating variable (firm size) on both models. Because the null hypothesis was rejected, it was determined that the fixed effect model was the most appropriate model. As a result of these findings, audit committee independence might be utilized to forecast earnings quality in the presence of ownership concentration as an indicator for non-financial enterprises listed on the Nairobi Securities Exchange.

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