EFFECTIVENESS OF AUDIT COMMITTEE ON THE PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

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A RESEARCH PROJECT REPORT SUBMITTED TO THE SCHOOL OF BUSINESS IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTERS IN BUSINESS ADMINISTRATION (MBA).

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

FALL 2018
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ___________________________    Date: ___________________________

Paul Mugwe (ID 622389)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ___________________________    Date: ___________________________

Timothy C. Okech, PhD

Signed: ___________________________    Date: ___________________________

Dean, Chandaria School of Business
DEDICATION

I dedicate this study to my wife Catherine, my son Mugwe, my daughter Njeri, my niece Tracy without forgetting my supervisor and friend Prof. Timothy Okech. Without you all, this may not have been possible. Thank you.
ACKNOWLEDGEMENT
This project would not materialize without the kind and overwhelming support received
and which I sincerely recognize. I salute my supervisor and my wife for sacrificial in-
depth guidance and invaluable insights that culminated into the success of this work.
Thank you.
ABSTRACT
The purpose of this study was to examine the relationship between audit committee effectiveness and performance of commercial banks in Kenya. Specific objectives pursued were: to examine the influence of audit committee independence on the performance of commercial banks in Kenya; to determine the influence of audit committee composition on the performance of commercial banks in Kenya; to find out the effect of audit committee technical skills on the performance of commercial banks in Kenya; and to determine the moderating effect of prudential requirements on the relationship between audit committee and performance of commercial banks.

The study was a case analysis of commercial banks in Kenya. The methodology used was a descriptive study focusing on process of implementation and the results thereof. The case was used in order to increase the likelihood of high quality data but not necessarily as an object of interest in its own right. The data and information was collected using questionnaires. The target population of the study consisted of the members of the audit committee who made a target population of 210 respondents. The sample size of 60 respondents was generated by random sampling. Data was analysed through descriptive statistics using Statistical Package for Social Scientists (SPSS) in order to give quantifiable statistics and results done with the help of Microsoft Office Excel programme and presented in pie charts, bar graphs and tables.

In terms of findings with regard to the influence of an audit committee independence on the performance of commercial banks in Kenya, the study revealed that audit committee independence has great influence in the performance of commercial banks in Kenya as an independent audit committee fosters effective feedback and control of their functions, fosters objectivity and integrity in the committee functions and enhances integrity of the auditor's opinion, conclusion and recommendations. Regarding the influence of audit committee composition on the performance of commercial banks in Kenya, the study established that an audit committee must be well and efficiently composed in order to increase performance. Further, it was revealed that audit committee composition is significantly related with performance of commercial banks in Kenya. With respect to the technical skills of audit committee on the performance of commercial banks in Kenya, the study established that experience and expertise of audit committee members in
accounting and/or financial management is positively related to the quality of financial reporting and timeliness.

Based on the findings, the study concludes that the independence, composition, technical skills and prudential requirements of the committee are key in the ensuring that there is an effective and probably efficient audit committee to monitor, check and evaluate the financial functions and practices of an organization. In terms of recommendations, it is recommended that there is need for the audit committee to continuously update themselves with the changing times and technologies and sharpen their skills. By applying skills to the most critical points, building personal and professional credibility and recognising and responding to the needs, auditors can become indispensable thus speeding good governance and enhancing efficiency of audit committees. The management of commercial banks should keep organizing training seminars and workshops whereby these audit committee members would be trained frequently by experts either internally or externally. Commercial Banks should ensure the staff competency, professional auditing and offer guidance needed for audit staff committee, knowledge of auditors on auditing techniques, and efficiency of the auditors. They must also ensure the effectiveness of audit committee operations so as to establish and maintain effective accounting controls, provide reasonable assurance for safeguarding company assets, eliminate corruption and fraud cases, provide consulting services to assist management in implementing of governance processes to improve corporate governance.
TABLE OF CONTENTS

DECLARATION .................................................................................................................. ii
DEDICATION ..................................................................................................................... iii
ACKNOWLEDGEMENT ..................................................................................................... iv
ABSTRACT ....................................................................................................................... v
LIST OF TABLES ............................................................................................................... ix
LIST OF FIGURES ........................................................................................................... x
CHAPTER ONE .................................................................................................................. 1
  1.0 INTRODUCTION ...................................................................................................... 1
    1.1 Background of the Study ......................................................................................... 1
    1.2 Statement of the Problem ....................................................................................... 5
    1.3 General Objective .................................................................................................... 6
    1.4 Significance of the Study ....................................................................................... 7
    1.5 Scope of the Study ................................................................................................... 7
    1.6 Definition of Terms ............................................................................................... 8
    1.7 Chapter Summary ................................................................................................... 8

CHAPTER TWO .................................................................................................................. 9
LITERATURE REVIEW ...................................................................................................... 9
  2.1 Introduction ............................................................................................................... 9
  2.2 Audit Committee Effectiveness and the Performance of Commercial Banks ........... 9
  2.3 Effect of Audit Committee Independence on Performance of Commercial Banks . 12
  2.4 Effect of Audit Committee Composition on the Performance of Commercial Banks ......................................................................................................................... 14
  2.5 Effect of Audit Committee Technical Skills on the Performance of Commercial Banks ......................................................................................................................... 17
  2.6 Effect of Prudential Requirements on the Performance of Commercial Banks ...... 21
  2.7 Chapter Summary ................................................................................................... 24

CHAPTER THREE ............................................................................................................ 25
LIST OF TABLES

Table 3.1: Overall Reliability Statistics ..............................................................28
Table 4.1: Gender ........................................................................................................31
Table 4.2: Level of Education ....................................................................................32
Table 4.3: Position Held ............................................................................................32
Table 4.4: Years of Service .......................................................................................33
Table 4.5: Effect of Audit Committee Independence on Performance of Commercial
           Banks in Kenya .................................................................................................34
Table 4.6: Regression .................................................................................................36
Table 4.7: Effect of Audit Committee Composition on Performance of Commercial Banks
           in Kenya ..............................................................................................................37
Table 4.8: Regression .................................................................................................39
Table 4.9: Effect of Audit Committee Technical Skills on Performance of Commercial
           Banks in Kenya .................................................................................................40
Table 4.10: Regression ...............................................................................................41
Table 4.11: Effect of Audit Committee Prudential Requirements on Performance of
           Commercial Banks in Kenya ..........................................................................42
Table 4.12: Regression ...............................................................................................43
LIST OF FIGURES

Figure 4.1: Age ........................................................................................................31
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Worldwide, the banking sector is considered to play an important role in economic development. Zenios and Harker (2004) define performance of banks as the economic performance as measured by a number of financial indicators. They explain that in order for banks to improve their performance they should provide quality services and products and also have efficient risk management which can only be achieved with the right leadership in place. Good bank performance is therefore essential for the stability of the banking sector and the economy in general (Gu, Weng, & Xie, 2012). In order to evaluate firm’s performance it is necessary to determine the constituents of good performance that are measurable and that are relevant to the organization in question. In the realization of this, there has been an upsurge of initiatives by Central Banks and Reserve Banks alongside other institutions worldwide such as the Basel Committee on Banking and Supervision and OECD to provide governance principles with a view of enhancing management and performance of this important sector. Most of these initiatives have prominently featured in developed nations including U.S.A, United Kingdom, Germany, Canada, and France and South Africa aimed at addressing corporate governance issues (Elewechi, 2007). Central to the corporate governance mechanisms within major commercial banks is the operationalization of a robust internal auditing department (Belay, 2007).

The professional practice of Internal Audit (IA) was first initiated in 1941 in USA. The audit committee only focused on financial audit which was far away from financial statement (Cohen, Aaron, & Sayag, 2010). In the recent years, organizations have been declared bankrupt due to an increase number of accounting scandals that solely focuses only on financial audit. This has led to the audit function receiving attention as it plays an important role in effective and quality financial reporting and corporate governance practice (Prawitt, Douglas, Smith,, & Wood, 2009). Internal auditing and the role played by audit committee have gained significance with the consequence of these corporate failures (Swinkels, 2012). Meanwhile, increasing attention has risen on issues such as performance evaluation and effectiveness of the auditing role (Abu-Azza, 2012; Wubishet & Dereje, 2014; Endaya & Hanefah, 2013). The effectiveness of internal audit
committees has brought into attention by the increasing corporate governance mishaps and increasing fraud in the financial sector (Mihret, Mula, & James, 2010).

To create a strong corporate organization auditing plays a critical role in governance and operation of the organization (Changwony & Rotich, 2015). In addition of this, during statutory audit, it reduces the time spent by external auditors (Goodwin-Stewart & Kent, 2006). It is mandatory to enhance the quality of IA activities since external auditors are likely to rely more on internal auditors’ report (Goodwin-Stewart & Kent, 2006).

Transparency, public accountability, responsiveness, and effectiveness are the four good governance characteristics (Belay, 2007). Effectiveness is the ability of an organization to account successfully for its output and operations to its various internal and external constituencies (Gregory & Ramnaravan, 2008). This can also be defined as the achievement of goals and objectives of an activity through the factor measures provided (IIA, 2010). Mihret and Yismaw, (2007) notes that effectiveness in audit is a composite matter involving the capability of the auditor to carry out an audit free of errors, readiness to function when needed, having adequate competent personnel and identify suitable set of objectives.

Effectiveness of the audit committee has been contextualized distinctively by different scholars, Arena and Azzone (2009) indicated that it primarily centres on the co-operation between internal auditors and external auditors, management support, and organizational setting. Wubishet and Dereje (2014) observed that it revolves on the proficiency, objectivity, performance, and information technology. George, et al., (2015) concludes that effectiveness of audit entails the quality of the audit, competence of auditing team, independence of auditing team, and management support. From the above it is evident there is no consensus among researchers on what aspects of audit effectiveness are integral within a multi-sectorial approach. The current study will conceptualize effectiveness of audit committee based on the audit committee independence, audit committee technical skills and the audit committee composition and how they influence the performance of commercial banks in Kenya.

There is no consensus in literature on reliable performance measures in studies on corporate governance (Jong, Gispert, Kabir, & Renneboog, 2002). However, much of the existing literature has used accounting based measures such as return on equity (ROE)
and return on asset (ROA) and market based measures such as Tobin’s q (Heentigala & Armstrong, 2011). The use of return on asset (ROA), return on equity (ROE) and Tobin’s q as performance measures are in line with the argument that use of only accounting or market measures of performance are responsible for inconsistencies in establishing a clear relationship between governance mechanism and performance of firms (Bocean & Barbu, 2005). On the other hand Kaplan and Norton (2001) are of the view that performance should be measured using both financial and no-financial measures. The current research will adopt a mix of both financial and non-financial measures in assessing the performance of commercial banks.

Commercial banking is the backbone of the economy of the country in which they’re engaged (Keatinge, 2014). Due to this fact the effectiveness of the audit committee in commercial banks cannot be undermined. Effectiveness of the audit committee would have a positive consequence on safe and sound banking system (Gamage, Lock, & Fernando, 2014). This will help to safeguard the resources of bank and promote production of reliable financial reports, and to comply with laws and regulations (Gamage, et al., 2014). Toor and Ofori (2009) explored the effectiveness of ethical practices on competitiveness and it was revealed that firms that maintained ethical principles and standards were able to save huge costs from fines and penalties and this contributed towards improved performance.

Gu, Weng and Xin (2012) found that firms that complied with ethical codes of conduct were able to create ample time and resources towards achieving their set goals and targets. Holloway (2012) observed that many employees who maintained integrity in their work were employees of firms that were compliant with ethical principles. Al-Hawary. (2012) empirically investigated the impact of corporate governance on performance using 15 Jordanian banks listed on Amman Stock Exchange for the period 2007 to 2009 with a total of 45 bank-year observations. The study revealed a significant negative relationship between board size and banks performance as measured by return on equity and earnings per share. The study also revealed a positive association between board audit committee independence and bank performance measures.

Al-Matari, Mohammed and Al-Matari, (2017) in a study in Yemen, indicated that audit committee attributes such as technical skills, composition and size were positively related to a stronger internal control systems within banks which enhanced the bank
performance. George, et al., (2015) conducted a study on factors determining IA effectiveness in Greece business environment and concluded that there was positive association between audit effectiveness and the organization performance. Bidley and Burbach (2010) did a study on the effect of ethical practices on performance of German financial sector and the results showed that ethical practices provided a supportive environment for employees to work with minimal interference from regulatory authorities. Lufthans (2012) concluded that ethical effectiveness among banks’ audit team greatly impacted on employees’ attitude and perception.

The study on the effectiveness of the audit team in Tanzanian commercial banks and concluded that there was positive relationship between audit team resources and competencies and audit team effectiveness, a significant relationship between level of interaction between the internal auditors with audit committee and its effectiveness, and no significant relationship between audit activities and their effectiveness (Ramachandran, et al., 2012). This also impacted on performance and competitive advantage. The main reason for failure of commercial banks in Kenya and Nigeria has been lack of effectiveness in their audit function. Consequently, the experiences of such a failure have called for the transformation and strength of IA in those nations (Okafor & Ibadin, 2009; Changwony & Rotich, 2015). This becomes relevant; given the fact that effective audit committees are critical for the survival of strong commercial banks. In Tunisia, Zgarni and Fadhila, (2018) determined that the number of audit committee meetings, the composition and size had a material effect on the financial reporting and performance of the commercial banks.

Ogoro and Simiyu (2014) also conducted a study on effectiveness of audit committees in the public sector: a case of parastatals in Kenya. The researcher found that the most important and influential characteristics of audit committees is multiple directorships and audit committee tenure. Outa and Waweru, (2017) examined corporate governance guidelines compliance and firm financial performance: Kenya listed companies and concluded that compliance with corporate regulations and internal controls had a positive influence on the firm value.

Malesi and Njeru, (2017) examined corporate governance practices and the performance of listed commercial banks in Kenya and indicated the number of audit committee members should be increased and the composition of independent directors be the
majority to enhance the discharge of duties and foster performance. Mandala, Kaijage, Aduda, and Iraya (2018) examined board structure and performance of financial institutions and concluded that having independent audit teams was positively related to performance. They further indicated that board size and compensation was positively related to performance of financial institutions.

1.1.1 Commercial Banks in Kenya
Abba (2016) defined a bank as an institution of finance that engages in offering banking and other financial related services to clients. Generally, banks are categorized under financial services sector. The banking sector makes a great contribution towards the growth of an economy. Roles of commercial banks include receiving deposits, offering credit to customers and institutions, safe custody of valuables and financial advisory services. Commercial banks all over the world operate in an uncertain macroeconomic environment and therefore have to deal with a number of challenges and their ability to make profit. The ultimate test of a bank’s performance is its ability to make profit which justifies the banks leadership, policies and activities (Guo, Langston, & Hadley, 2012).

The wave of mergers, acquisitions and collapse of banks witnessed in Kenya and other parts of the world came as a wakeup call to the Central Bank of Kenya to strengthen its bank supervision arm. In order to achieve this, Central Bank of Kenya has on different occasions issued prudential guidelines on corporate governance that all institutions licensed under the Banking Act Cap 488 laws of Kenya are supposed to adhere to (Central Bank of Kenya, 2007). The Central Bank of Kenya which plays a regulatory and monitoring role of the commercial banks is at the apex of the industry with the rest of the banking industry being a pyramid of financial activity comprising; five regulators, 43 commercial banks, 10 investment banks, two development banks, one mortgage finance company, 41 insurance companies, nine deposit taking micro-finance institutions, and 3,887 Savings and Credit Co-operatives Societies (SACCOs) (CBK, 2017); the research will only focus on the 43 commercial banks.

1.2 Statement of the Problem
Commercial banks play a key strategic role in the development of the financial sector and are primary drivers of economic growth of the country. Hence their performance is of imperative performance within any economy. The function of audit committees is of key importance in ensuring quality and reliable financial reporting is upheld within these
institutions. In developing economies, the independence, composition and technical skills of the audit committees has often been compromised by both internal and external forces of the commercial banks. This has led to ineffectiveness of the audit committee in delegation of its oversight role (Turley & Zaman, 2007).

Adigwe, Onyenwe and John, (2016) examined corporate governance mechanism and financial performance of banks in Nigeria and noted that board audit committees, the board composition and the board technical skills were positively related to return on assets. Chou and Buchdadi (2017) indicated that board independence, audit committees (size and number of meetings), committee compensation were all positively related to performance of listed Indonesian banks. In a Malaysian study (Kallamu & Saat, 2015); examined audit committee attributes and firm performance and indicated that size, composition, technical skills and independence had a positive effect on performance of Malaysian financial companies. The above studies were not undertaken locally hence the findings may not be representative of the current research scope.

In Kenya there have been numerous incidences of bank failure, ethical malpractice and cases of fraud within commercial banking institutions (Waweru, 2015). In the recent past at least two commercial banks have been put under receivership due to poor adherence to prudential guidelines and lack of reliable governance practices. This has led to criticism of the role played by the internal auditors in protecting shareholders and depositors (Mandala, Kaijage, Aduda, & Iraya, 2015). There have however been limited studies on the relationship between audit committees and the performance of commercial banks. The study examining the relationship between audit committee effectiveness and performance of commercial banks in Kenya

1.3 General Objective
The main objective of the study was to examine the relationship between audit committee effectiveness and performance of commercial banks in Kenya

1.3.1 Specific Objectives
i. To examine the influence of audit committee independence on the performance of commercial banks in Kenya

ii. To determine the influence of audit committee composition on the performance of commercial banks in Kenya
iii. To find out the effect of audit committee technical skills on the performance of commercial banks in Kenya
iv. To determine the moderating effect of prudential requirements on the relationship between audit committee and performance of commercial banks.

1.4 Significance of the Study
The research findings were of importance to a number of factions including;

1.4.1 Executive Management
The research findings were of importance to the executive management and board of directors in enhancing their managerial practice towards better performance. The findings will also guide their interactions with the audit committee.

1.4.2 Policy Makers
The findings of the research were of importance to policy makers within regulatory bodies by highlighting the importance of audit committee as a mechanism of fostering stability and performance within the banking sector.

1.4.3 Researchers
The research findings were also of importance to future scholars examining the auditing function and performance of institutions within other sectors.

1.4.4 Institutions
The results were also useful to the organizational leaders and various level decision makers in the financial sector institutions. They will assist them understand and implement effective auditing units so as to contribute towards the institutions being competitive.

1.5 Scope of the Study
The contextual scope of the study was guided by a review of the audit committee effectiveness and the performance of commercial banks. The geographical scope of the study was restricted to commercial banks operating within Nairobi City County and concentrated on auditors/members of audit committees. Nairobi County houses most of the commercial banks in Kenya hence was a suitable location.
1.6 Definition of Terms

Audit - as per this study this refers to an evaluation of an organization, system, process, or product which is performed by a competent, objective, and unbiased person or persons, known as auditors.

Audit Committee - refers to the governance body which is charged with oversight of the organization's audit and control functions

Board - is an organization's governing body

Charter - is a formal written document that defines an organization's purpose, authority and responsibility.

Corporate governance - the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with all its stakeholders.

Governance - the combination of processes and structures implemented by the board in order to inform, direct, manage and monitor the activities of the organization towards the achievement of its objectives

Public - the community or the people in a country

1.7 Chapter Summary

This chapter reviews the introduction to the study. It contains the background of the study, the statement of the problem, the objectives of the study, the research hypothesis and the scope of the study. The next Chapter will provide Literature review followed by research design and methodology in chapter three, data presentation analysis and results in chapter four. Finally, in chapter five, summary, discussion, conclusion and recommendations are provided in that order.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
The second chapter of this research document presents the structure of the literature review on which the study has been grounded on. This chapter will contain a comprehensive review of related literature. Theories underpinning the study on the performance will be reviewed and relevance to the research problem ascertained.

2.2 Audit Committee Effectiveness and the Performance of Commercial Banks
Events since mid-1970s have contributed to the growth of auditing. The foreign Corrupt Practices Act of 1977 mandated public companies to establish and maintain effective internal accounting controls to provide reasonable assurance that assets are safeguarded and transactions are properly authorized and recorded. To accomplish this, many companies established internal audit functions, increased internal audit staffing, and strengthened internal audit independence. Beasley et al. (2010) show that these investments in auditing have been effective, as companies with audit committees are less prone to financial fraud than companies without audit committees.

Only a few academic studies have examined the effectiveness of audit, and even fewer have dealt with the issue empirically. In one of the very few studies that examined the effect of internal auditing on organisational performance, Eden D, (2006) assigned bank branches to experimental conditions (audited or not audited) and monitored their performance for a year. Their findings showed that performance significantly improved during the half year following the audit in the experimental branches, while the control branches experienced a decline due to poor general business conditions. While that study offers a useful jumping-off point for understanding how good auditing can improve a company's performance, it does not go far enough in explaining when and why the audit committee works and in what way it improves the performance. Helping to bridge this gap was one of the main contributions of this study.

Wee Goh (2009) studied on audit committees, boards of directors, and remediation of material weaknesses. He measured the effectiveness of the audit committee by its independence, financial expertise, size, and meeting frequency, and the effectiveness of the board by its independence, size, and meeting frequency, and by the duality of the
chief executive officer (CEO) and chair positions (CEO duality). He also examined other factors that can affect firms' timeliness in the remediation of material weaknesses, such as the severity of material weaknesses, firms' profitability, the complexity of firms' operations, and so on. He found out that the proportion of audit committee members with financial expertise is positively associated with firms' timeliness in the remediation of material weaknesses. Second, firms with larger audit committees are more likely to remediate material weaknesses in a timely manner. Third, that a more independent board is less susceptible to the undue influence of management and more likely to exert pressure on management to remediate material weaknesses. Wee Goh (2009) however did not study how these factors affected performance.

Crutchley et al. (2007) studied the likelihood of a firm being involved in an accounting scandal. The study found that certain characteristics increased the likelihood of a firm being involved in an accounting scandal. The characteristics included high levels of growth of a firm, engaging in earnings management techniques, audit committees composed of few directors and overextended outside directors. However, firms with low level of growth and having audit committees composed of more directors had a lesser likelihood of being involved in accounting scandal. Strong management, audit committee and an ethical organizational culture were found key in preventing a firm from being involved in accounting scandal.

There are two theories which further explain the relationship between audit committee and performance of commercial banks. They are:

2.2.1 The Agency Theory
The agency theory holds that a firm is made up of owners of the resource (principals) and the managements (agents) (Jensen & Mackling, 1976). The agents of the firm have more information than the principals which creates an information asymmetry which affects the ability of the firms’ owners to monitor whether there interests are being protected by the agents (Jensen & Mackling, 1976).

In order to ensure harmonization of the interests of the principal and their agents the theory points that a comprehensive contract is necessary to ensure that the interests of the principals are met. The relationship between the agent and principal is further strengthened by employing experts and systems such as audit and control environment
(Jussie & Petri, 2014). Further, the theory recognizes that any incomplete information about the relationship, interests or work performance of the agent described could lead to selection problem. Adverse selection and moral hazard impact on the output of the agent in two ways; not possessing the requisite knowledge about what should be done and not doing exactly what the agent is appointed to do respectively. The agency theory, therefore, works on the assumption that principals and agents act rationally and use contracting to maximize their wealth (Jensen and Mackling, 1976). This theory was essential to the study since the audit control committee is one the mechanisms employed to ensure that no agency problem exists within the firm.

### 2.2.2 Attribution Theory

Attribution theory is a social psychology theory that explores how people interpret events and behaviours and how they ascribe causes to the events and behaviours. According to Schroth and Shah (2010), studies using attribution theory examine the use of information in the social environment to explain events and behaviours. Reffett (2011) asserts that when evaluators believe comparable persons would have acted differently in a given circumstance, they (evaluators) tend to attribute responsibility for an outcome to the person. According to Wilks and Zimbelman (2014), the first case refers to internal or dispositional attributions while the second one refers to external or situational attributions.

The auditor’s accountability for detecting fraud is extended by Reffett’s (2011) study which predicted that auditors are more likely to be held accountable by evaluators when the auditors fail to detect fraud after they had identified the fraud occurrence as a fraud risk. The result of Reffett’s study shows an increase in auditors’ liability when an audit fails after the auditors had identified the perpetrated fraud as a fraud risk and performed procedures to investigate the identified fraud risk.

Attribution theory thus advocates for auditors to report on the effectiveness of firms. Auditors are therefore expected to gain a better understanding of the internal controls in place, assess the design and implementation of the internal controls, and test the operating effectiveness of the firm. This is deemed necessary for the auditors’ reliance and possibly scaling back of other substantive audit procedures for the required performance.
The attribution theory suggests that when fraud occurs, identified parties should be held accountable and auditors, being the “public watchdogs” are most likely to be held accountable if evaluators determine substandard audit services were provided (Reffett, 2011).

This study will seek to examine the effect of each of the objectives on performance of commercial banks.

2.3 Effect of Audit Committee Independence on Performance of Commercial Banks

According to Cai Chun (2017) Independence is the essence of auditing. An audit committee must be independent of both the personnel and operational activities of an organization. Otherwise, the integrity of the auditor's opinions, conclusions and recommendations would be suspect. So, independence is necessary for the effective achievement of the function and objective of internal audit. This independence is obtained mainly from two characteristics; organizational status and objectivity.

The audit committee plays a monitoring role of the firms providing vital information to the legislature, the media, the citizens, and other organizations and points to its value in serving the public interest (Baxter & Cotter, 2009). It is therefore important for the audit committee to have its own independence for it to execute its duties of financial management in an appropriate manner. If it lacks independence the audit committee may be puppet committee which cannot execute its duties appropriately. The independence of an audit committee is considered a vital characteristic influencing the committee's efficiency in managing the process of financial statements (Baxter & Cotter, 2009). The independence of an audit committee can serve as active to control the financial reporting. Therefore, audit committee independence has been found to be significantly associated with measures of earnings quality in prior studies.

Audit committees should be independent both in fact and in appearance, and have processes in place to ensure such independence (Stewart and Longley, 2012). An audit committee must be independent to contribute to the integrity of the financial reporting process. An independent audit committee can help reinforce a culture with zero tolerance for fraud. The combination of independent oversight and the technical expertise of audit committee members enhance accountability (Stewart and Longley, 2012). An audit committee may often be empowered by the governing body to select or recommend the
external auditors, which would be formally approved by the governing body. In doing so, the audit committee should consider the following factors: auditor independence; the firm's reputation and fees; the firm's scope of services and experience; and the firm's quality-control standards (Schandl, 2015).

Active and independent audit committees can influence the extent of the audit (Dczoort, 2014). Independent directors on audit committees have incentives to protect their reputation and avoid potential litigation. These incentives can be explained by the demand-based perspective in the context of regulatory oversight and the scrutiny of the role of independent directors (Lorenzo, 2011). The demand-based perspective suggests that independent directors seek differentially higher audit quality. Such greater assurance provided by the external auditor necessarily requires additional audit work which is reflected in higher audit fees (Carcelle et al. 2012).

Bean (1999) argued that only independent directors should serve on the audit committees, The Blue Ribbon Committee also recommends that only independent directors should serve on the audit committees, a recommendation that was adopted in Kenya by the Capital Markets Authority (CMA 2002). However, Attwood (1986) argued that the composition of the audit committee would depend on the circumstances of the particular company. Bean (1999) described an independent director as one who is free of any relationship that could influence his or her judgment as a committee member. An independent director may not be associated with a major vendor to, or a customer of, the company. When there is doubt about independence, Bean (1999) advised that the director should excuse himself from any discussions that might be influenced by that relationship. Pomeranz (1997) stated that there is a concern as to what constituted independence on the part of an audit committee member. He argued that a further decision needs to be made as to whether emphasis should be placed on independence in fact rather than on independence on appearance.

An audit committee must be independent to contribute to the integrity of the financial reporting process. An independent audit committee can help reinforce a culture with zero tolerance for fraud. The combination of independent oversight and the technical expertise of audit committee members enhance accountability (Stewart and Longley, 2002). Abbott et al. (2000) show that firms with audit committees which are composed of independent members and which meet at least twice per year are less likely to be sanctioned for
fraudulent or misleading reporting. 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 that good audit committees can affect shareholder perceptions related to the auditor, particularly in those situations where shareholders might perceive an increased threat to auditor independence. Mustafa and Meier (2006) in their study show that the percentage of independent members in audit committees and the average tenure of audit committee members are significantly and negatively related to the incidence of misappropriation of assets in companies in both the random and the matched models while the number of audit committee meetings is not significant.

Several studies suggest that firms with more independent directors perform worse than those with relatively fewer independent directors. For example, Agrawal and Knoeber (2006) reported a negative correlation between the proportion of outside directors and Tobin's Q index (which is a measure of growth prospects of assets, defined by the future profitability of the asset in relation to its replacement cost). This is consistent with evidence established by Bhagwat and Black (2007) that a high proportion of independent directors is strongly correlated with slower past growth across a number of accounting variables, but not so with future performance. Evidence from Bhagwat and Black (2007) and Klein (2007) also shows that a high proportion of independent directors correlates with lower past profitability. This advocates for accountability in the form of auditing to maximize on efficiency.

2.4 Effect of Audit Committee Composition on the Performance of Commercial Banks

The composition of the committee is critical to its effectiveness. Members with requisite skills, knowledge, independence and judgment are important. Their level of commitment and availability is also critical to the audit committee’s ability to perform its responsibilities effectively. A range of diverse perspectives and thinking helps strengthen the quality of audit committee deliberations and delivers real value for companies and shareholders, especially for companies that operate globally. Focus on committee composition, including independence, financial expertise, broad business or leadership
experience and succession planning is critical for company’s accountability (Taboi, 2010; Di Napoli, 2007).

A company needs to evaluate the audit committee expertise and competence of the members in the context of the company’s strategy and risk profile today and for the next several years. The right balance is crucial and will fluctuate with changing circumstances. To consider the ability to work collectively, to challenge decisions in a credible manner and to avoid “groupthink”, align audit committee meeting materials and agendas with priority areas: which incorporates putting significant areas first in advance materials and on the agenda, include and discuss matters for review and make comments, present compliance matters, standard reports and informational items at the end of advance materials packages and meetings, follow meetings with private and executive sessions with auditors and the internal auditor and to help promote healthy scepticism among fellow committee and board members of the company (Ernst and Young, 2012; Taboi, 2010).

The committee needs to consider alternative viewpoints, evaluate whether the company’s crisis preparedness is adequate, consider periodically rotating audit committee members, staggering the terms of service to have the benefit of new skills and perspectives, engage independent advisers, as necessary, recognize the significant workload of board service, and especially of audit committees, consider policies limiting directors’ other board service or audit committee participation and to conduct an annual committee self-evaluation, considering what the committee could have done better and what the committee needs to do next year and beyond (Ernst and Young, 2012).

Braiotta (1999) stated that the effectiveness of the audit committee depends on the background of the members and of the chairman. He argued that the membership of the audit committee should consist of both financial and non-financial people so that the committee can draw upon members from various professionals such as accounting, economics, education, psychology, and sociology. Equally important, Braiotta (1999) stated that the chairman has a critical role in coordinating the committee’s tasks. The success or failure of the operation could depend on the chairman and therefore such a person should be chosen with great care. Although there is general consensus regarding the size of audit committees, obviously, the number of members will vary from corporation to corporation. The number of members depends not only on the committee’s
responsibilities and authority, but also on the size of the board of directors and the company (Braiotta 1999).

The audit committee is composed of directors who provide decisions on how the finance of a company will be used and managed. They usually give the final decision before any financial transaction takes place. The committee is appointed by the board of directors in compliance with the charter. Members of the audit committee are considered independent if, in the opinion of the board of directors, they have no relationship that may interfere with the exercise of their independence in carrying out the responsibilities of a director. All audit committee members should be able to read and understand fundamental financial statements, including a balance sheet, income statement, and cash flow statement (Bond & Dent, 2008). At least one member must have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background that results in the individual's financial sophistication, including service as a chief executive officer, chief financial officer, or other senior position with financial oversight responsibilities or otherwise satisfy standards for financial expertise required for audit committees of companies.

Herdman (2002) argued that because the road to becoming an audit committee member begins with the nomination process, independent parties, not the CEO/chairman, should be responsible for nominating members of the audit committee. Herdman (2002), quoting former SEC chairman Rodhills, argued that an ineffective audit committee should be considered a material weakness in internal controls, and that a prerequisite to effectiveness is the total independence of the members of the committee, including the nomination process.

Tackett (2004) stated that although the audit committee represents the interests of stockholders, current procedures make it difficult for an individual stockholder to become a candidate for the board of directors without the blessings of corporate management. He also stated that under normal circumstances, senior management or other directors nominate board candidates. Management fully recognizes the power implications of selecting board candidates who will be sympathetic to their needs. The result, Tackett (2004) argued, is often a board whose composition is biased towards the interests of management instead of the stockholders. If senior management can control the
composition of the board of directors, then they also control the composition of the audit committees, which erodes their independence.

Proper planning in audit involves also the right composition of an audit committee. The right composition enables accomplishment of a large number of audits in a given period by improving efficiency. In some cases the numbers of the audit engagements are completed in the budgeted time and the number of actual audits performed in a period is usually less than the number of audits stated in the annual audit plan (Sanda, Milkailu and Garba. 2015). This is usually caused by adhoc audit assignments by the management and urgent requests by external parties. Adhoc audit assignments signify the relevance of the right internal audit team to management (Van Gansberghe, 2015), and reflect positively on audit effectiveness and also in good governance.

Perpetrators actively engage in deception in an attempt to conceal their behaviour, auditors may have limited experience in fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect (Herz and Schultz, 2009; Kaplan et al., 2001; Nieschwietz et al., 2010). Hence, the organization would be optimally served by identifying and utilizing those individuals who, because they appear to share certain unique personality traits or characteristics, may be best suited to the fraud detection task. For example, Uecker et al. (2011) used perceptions of relative aggressiveness between internal and external auditors to investigate the detection of corporate irregularities. Auditors play an important role in fraud detection with most frauds identified by the audit function (KPMG, 2013, Norman et al., 2010).

Due to the importance of effective fraud detection, any measures that can enhance the efficacy of auditors should be of value. While experience and ability are undeniably important in the detection process, certain individual characteristics may be predictive of the capacity to detect fraud (Ashton, 2009). These individuals are what should set up the ideal audit committee for efficiency in the company.

2.5 Effect of Audit Committee Technical Skills on the Performance of Commercial Banks

Audit quality, which is determined by the audit committee’s capability to provide useful findings and recommendations, is central to audit effectiveness. The audit committee has to prove that it is of value to the organization and earn a reputation in the organization.
The audit committee has to evaluate its performance and continually improve its service. According to Ziegenfus, (2010), audit quality is a function of the level of staff expertise, staff technical skills, the scope of services provided and the extent, to which audits are properly planned, executed and communicated.

To be able to achieve this, the audit committee members need to be trained and taught on the basics and the principles of the role of the committee members, in order for them to effectively and efficiently deliver on the outputs of the responsibility required of them. Prior research provides empirical evidence of the effects of knowledge and experience on audit committee members’ exercise of independent judgments. For instance, experienced audit committee members who also have audit knowledge are more likely to support the auditor in an auditor management dispute case over an accounting policy (i.e. substance over form) than audit committee members who have concurrent experience as an independent board director and senior member of management (DeZoort and Salterio, 2001).

The required standards on proficiency of the auditor require that auditors possess the knowledge, skills and other competencies needed to perform their responsibilities (ILA, 2010). The auditors’ should be interested in attending courses for the purpose of gaining professional qualification, such as for certification as an internal auditors and the employer can provide financial support where necessary. Since, audit work requires knowledge and experience on a wide range of systems and operations, it is imperative to deploy auditors with extensive professional skills and to upgrade their skills through continuing professional training and development. Given the high level of staffing with temporary employees, the difficulty of recruitment and retention of auditors with the right technical proficiency is evident. Krishnan (2015) revealed that the auditors view the office as given insufficient attention in terms of staffing. Continuous skill upgrading is another dimension that deserves attention so as to achieve a high level of technical proficiency. Therefore, audit quality is arguably a function of extensive staff expertise; reasonableness of the scope of service; and effective planning, execution and communication of the audit committee.

The audit committee needs professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. In order to ensure good governance, auditors must comply with minimum continuing
education requirements established by their relevant professional organizations and standards. The head of the audit activity must be able to effectively recruit, retain, and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit activity (Kunkel, 2014).

Shamsher, Mohamad & Zulkamain (2001) state that members of the audit committee should ideally be individuals with integrity, a sense of accountability and good track record. They should possess certain core competencies such as financial literacy, experience with organizations, leadership and strategic thinking. Most importantly they must have a significant degree of commitment to the company and its board and be able to perform objectively.

Zulkamain Mohamad Shamsher, Mohamad & Mohamad Ali Abdul Hamid (2001) state that the audit committee should consider a continuous training and education program to ensure that its membership has the proper background and knowledge base, and are updated with the current developments in accounting and finance. Audit committee members should continuously assess their strengths and weaknesses and identify gaps in knowledge and ‘know how’.

Audit committee members with academic and professional qualifications in financial institutions are effective monitors in reducing earnings management. The experience of the audit committee members is generally considered an important characteristic for its effective operation. The experience and expertise of audit committee members in accounting and/or financial management is positively related to the quality of financial reporting and timeliness. Audit committee with high frequency of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance. Similarly, Qin (2007) asserts that firms with higher quality of earning are more associated with audit committee members who have accounts training.

AICPA (2004) recommended that an audit committee should conduct a comprehensive self-evaluation on an annual basis. The self-evaluation can take different forms, involve a number of participants, and use diverse techniques. Most important, however, the self-evaluation should adopt a straightforward approach that will aid the audit committee in reassessing its strength and weaknesses and lay a foundation for future improvement. It is
important that the audit committee evaluate its performance by asking specific questions about the impact it has had on the organization, most importantly, in its financial reporting process, the annual audit, the relationship with the independent auditor, and members of management. The audit committee should include the chair of the board in the evaluation session and ask for his/her input. The evaluation should be comprehensive and should involve all audit committee members and the committee chair. The chair should consider the result of the audit committee member’s evaluation of each other in the text of the chair's evaluation of the members. The chair should consider whether any member should be rotated off the committee, and this should be done in consultation with the chair of the board. The member’s attendance records and level of participation should be considered during this process.

Studies show that the higher the collective financial reporting knowledge and experience of audit committee members, the higher the support they provide auditors in auditor-management disagreements regarding materiality judgments (DeZoort et al., 2003). Recent studies that have examined the association between the financial expertise of audit committee members and corporate financial reporting quality (Abbott et al., 2002; McDaniel et al., 2002; Farber, 2004). Farber (2004) find that, compared to a matched sample of non-fraud firms, fraud firms have significantly fewer financial experts (i.e., defined in the study as those who have accounting or related financial management expertise; a person who is or has been a senior corporate officer with financial oversight responsibility on their audit committees. Abbott et al. (2002) find that firms with financial experts on audit committees are less likely to experience financial reporting restatement or fraud. McDaniel et al. (2002) find that, when asked to identify clients’ reporting issues for discussion with the auditors, financial experts (e.g., those who possess employment experience or professional certification in accounting/finance) tend to focus more on activities which their experiences suggest are associated with quality concerns, such as restatements, while financial literates (e.g., those who are able to read and understand basic financial statements) focus more on non-recurring issues, or issues that have less important implications for reporting quality. In other words, financial items that are less critical to overall reporting quality can distract financial literates. Consistent with the empirical evidence, the professional literature suggests that boards of directors are taking a much closer look at the makeup of their audit committees.
2.6 Effect of Prudential Requirements on the Performance of Commercial Banks

According to the professional guidance of the Institute of Internal Auditors (IIA), in every type of entity, the audit committee should develop appropriate audit charter that specifies on how the audit function could be administered and approved by senior management. The government's constitution, charter, or other basic legal documents should establish the audit activity's powers and duties to assist the audit function to perform its role independently of management influence and objectively. It helps an organization in improving financial risk occurrence, control, and governance processes (IIA, 2004). Davidson, Goodwin, Stewart & Kent, (2005) argued that an auditor's duty is to give a fair and truthful view of a client's set of the company accounts, but auditors cannot guarantee that the company’s accounts are entirely free of errors and irregularities.

Pomeranz (1997) defined a charter as a formal statement of the charge, designed to acknowledge the existence of the audit committee in the corporate by laws. Guy (2001) argued that every company that has an audit committee should develop a tailor made charter for the committee. The board should approve the charter, and it serves as a guide to the audit committee in carrying out the responsibilities delegated to it by the board. As a prerequisite for the effective performance of the audit committee, Bralotta (1999) stated that the board of directors should either pass a formal resolution or amend the bylaws of the corporation in order to document the establishment of the committee. Bean (1999) argued that a comprehensive charter enhances the effectiveness of the audit committee, serving as a roadmap for committee members, a well thought out charter should be tailor made for the company, describe the committee’s composition, and specify access to appropriate resources. Bean (1999) also argued that a good audit committee charter organizes committee members’ responsibilities providing a systematic structure for discussions between the committee and management, the public accountant others. Using the charter as a checklist focuses an audit committee’s efforts and makes it much more effective than it otherwise might have been. KPMG (2009) stated that the audit committee charter has become an increasingly important document for helping members to focus on their specific responsibilities and also to help shareholders to evaluate the role and responsibilities of the audit committees.

The audit committee is responsible to the rest of the board and the shareholders, and its charter details what the shareholders reasonably can expect the committee members to do.
Nonetheless, even though a good charter exists and the audit committee faithfully discharges the duties described by it, changing conditions can make a periodic review and update advisable. Thus, Bean (1999) stated that the best audit committee charters are living, changing documents.

An effective audit committee can increase the integrity and efficiency of the audit process, as well as the system of internal controls and financial reporting. The audit committee is an integral element of accountability and governance. It plays a key role with respect to the integrity of the entity's financial information, its system of internal controls, and the legal and ethical conduct of management and employees.

An effective audit committee should have open lines of communication with management, internal auditors, and outside auditors. It should prepare an annual report to the governing body which identifies how the committee discharged its charter responsibilities, and which should be addressed to the full governing body. Reports should present significant accounting, internal control, and compliance issues; identify the authority and responsibility of the audit committee; discuss the review of the financial statements, annual reports, and accounting issues; and discuss the review of the auditor's management letter, internal controls, and compliance (Guthrie, 2011).

The transparency of firms’ actions and information plays a significant role in public oversight. Auditors can provide a direct link between transparency and the credibility of a certain firm. (Jones & Pendlebury, 2010). Lawmakers and the customer look to audits for assurance that government actions ‘are ethical and legal, and that financial and performance reporting accurately reflects the true measure of operations (Stewart and Longley, 2012).

Attwood (1986) stated that in practice the timing of meetings of audit committee needs to be scheduled well in advance in order to fit in with what is northerly a very tight timetable for the production of the company’s interim and final accounts. Likewise the audit committee may want to plan meetings with different departments and subsidiaries, so that over a period of years it covers the whole of the areas included in the terms of reference. Guy (2001) stated that most audit committees today have two to four scheduled meetings per year depending on the scope of their activities and the size of the company, Graziano (2004) differed with Guy and stated that audit committees are meeting more
frequently both formally and informally. Formal meetings are held at least four, and sometimes up to twelve times per year.

Typically, four of the meetings are in person, and last for three to four hours and include senior management, external audit and internal auditor (Graziano 2004). Adequate time should be allowed at each meeting so that the issues can be covered in a professional and complete manner. In addition to scheduled meetings, the audit committee must have authority to hold special meetings as needed (Guy 2001). Herdman (2002) stated that audit committee members must make the time, and take the time to achieve an adequate understanding of the company’s financial reports, to have time to consult with outside counsel and experts if necessary, to ask the tough and incisive questions, and to obtain answers that make sense. As such Herdman (2002) argued that an effective audit committee requires a commitment of quality and quantity time to allow thorough deliberations and discussions. This means that proper upfront planning, conduct of meetings and follow-up is essential.

Research studies involving meeting frequencies of audit committees and company variables have created some interest. Menon and Williams (1994) in a study cited by Joshi (2004) examined 200 companies and found that the number of audit committee meetings increased as the percentage of outside directors increased. Meeting frequency was positively associated with company’s size, monitoring and need of audit committee meetings. In its survey of audit committees, Price Water House Coopers (1999) found that audit committees among European companies met on average three to four times a year. The chairperson of the audit committee should prepare the meeting agenda. The chairperson, working with the chief finance officer, the audit manager, and the general counsel, along with input from external auditor, should prepare detailed agenda with topic and time allocations to help keep the committee focused. The chairperson should circulate proposed audit committee’s agenda to all committee members to obtain their inputs about topics that should be added. Under no circumstances should management alone prepare the audit committee’s agenda. Meeting agenda and related materials should be distributed to committee members in advance of scheduled meetings (Guy 2001)

Attwood (1986) stated that audit committees would find it most useful to keep minutes of its meetings. However, he argued that discussions between the audit committees and senior directors and managers might be inhibited if it takes place in the knowledge that
the matters raised will be minute and those minutes circulated. There is also the problem of filing an individual of sufficient seniority and confidentiality to do the minute-taking. Attwood (1986) stated that it is important for the audit committee to decide on the extent to which its minutes are circulated beyond its own membership. Above all, notes are useful in order to ensure that there is a proper follow up of the matters on which the audit committee decides that action is needed. The audit committee’s report is the basis for reporting on the board of directors’ charge to the committee. The report should be addressed to the full board of directors and explain their findings and recommendations concerning primarily the overall effectiveness of both the internal and external auditing functions and other areas within the original jurisdiction as defined in the charter. In addition, the report should be based on their participation in the audit planning process as well as their monitoring activities (Braiotta 1999).

2.7 Chapter Summary
The literature review highlights a number of theories in relation to the variables and the conceptual framework of the variables by analysing the relationships between them. The next chapter will present research design and methodology followed by data presentation analysis and results in chapter four. Finally, in chapter five, summary, discussion, conclusion and recommendations are provided in that order.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter highlights on the research methodology that was employed for the study. This includes the research design, the population and sampling design as well as the data collection instrument and the research procedures.

3.2 Research Design
A research design is a framework that guides the collection and analysis of the data. It is a detailed plan on how the study conducted investigations in the research problem in an economic manner, (Creswell & Poth, 2017). This study adopted both qualitative and quantitative data collection in a single study in which the study collected data concurrently and involved the integration of the data in one single stage of the research process (Creswell, 2013). The study adopted descriptive research designs in which the problem is clearly defined and the variables known (Sekaran & Bougie, 2016). Cooper & Schindler (2008) supports the view that when a research problem is well structured; hence a descriptive design is the most suitable method for solving it (Sekaran & Bougie 2016). Therefore, by selecting this design it allowed both the presentation of quantitative use of inferential statistics to test hypotheses for making predictions and qualitative descriptive data (Sifa et al., 2008).

3.3 Target Population and Sampling Design
Target population in statistics is referred as the specific population about which information is desired. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. The target population involved the audit committee of several commercial banks in Kenya. There are 42 banks in Kenya with an average of 5 members of the audit committee in each of the commercial banks. The target population was therefore 210 audit committee members.

3.3.1 Sampling Procedure
According to Kothari (2012), sampling is the process followed in acquiring information about a target population or a proportion of it. Samples for scientific studies can be drawn using both probability and non-probability based methods (Saunders, Lewis & Thornhill,
The sampling techniques that were applied in this study are; purposive and simple random sampling. Purposive sampling techniques involve selecting certain units or cases based on a specific purpose rather than random sampling (Cooper & Schindler, 2011). The study utilized purposive sampling in selecting personnel who were available, reliable, are knowledgeable about the area of the study on the strategy implementation and performance within the banks. This technique is used to select a unit of the population that is typical of the population based on the study’s judgment on their typicality (Orodho, 2009).

### 3.3.2 Sample Size

In order to select appropriate sample size the study employed simple random sampling technique. This method was the most suitable for this study because the population was divided into strata. Hence the researcher selected a stratum of 60 audit committee members from the commercial banks that were selected.

The sample size determination technique used was the Yamane formula as follows; this formula yields the best sample that is representative of the entire population.

\[
n = \frac{Z^2pq}{d^2}
\]

Where,

- \(n\) = desired sample size
- \(Z\) = standard normal deviation set at 1.96 (95% confidence level)
- \(P\) = proportion of the targeted population that have the characteristic focusing in the study estimated at 14.5% (0.145). In using a target population proportion of 14.5%, the researcher based the choice, on the argument by Mugenda and Mugenda (2003) that a population of 10%-30% can be used in a research to give statistically significant findings that are representative of the entire population.
- \(q\) = 1 - \(p\) (1-0.145)
- \(d\) = degree of accuracy set at 5%-degree proportion of error that should be accepted in the study (0.05) since the study is at 95% confidence level.

Thus Desired Sample \((n) = \frac{1.96^2*0.145*(1-0.85)}{0.05^2}\)
Hence; 

\[ n = (1.96 \times 1.96) \times (0.15 \times 0.855) = (0.05 \times 0.05) \]

\[ n = 60 \]

### 3.4 Data Collection

For the purpose of this research, a questionnaire was used as the main data collection instrument. The questions were formulated based on the objectives and research questions for this study. The questionnaire contained both structured and semi-structured questions that vigorously explored various aspects of market orientation on effectiveness. Questionnaires assisted in the collection of information from the respondents without affecting their schedules in their jobs and answered the questions at their own free time.

To ensure validity and reliability of the instruments, pre-testing was conducted and standardization of the instruments done to correct the loopholes found.

#### 3.4.1 Reliability and Validity

The internal consistency of the research instrument was assessed using Cronbach’s alpha coefficient which is commonly used when there are multiple Likert type questions in a survey/questionnaire that form a scale. The internal consistency Cronbach’s Alpha (α) ranges from 0 to 1, and it is a reliability coefficient that reflects how well the measurements items positively correlate to one another. In line with Nunnally (2008) recommendation, only constructs with a cut-off of 0.7 and greater was considered for further analysis in the study. To enhance the reliability of the survey instrument for this study, a pilot study was conducted on a random sample of 10 respondents then Cronbach’s Alpha coefficient was calculated to establish internal consistency of the instrument (Gliem & Gliem, 2003).

The Cronbach’s Alpha Test of reliability was used to test the reliability of the constructs describing the variables of the study. Values of Cronbach’s alpha ranges from 0 to 1 with values equal to 0.7 and above indicating that the questionnaire is reliable while values below 0.7 indicates that the questionnaire is unreliable.
Table 3.1: Overall Reliability Statistics

<table>
<thead>
<tr>
<th></th>
<th>Cronbach's Alpha</th>
<th>No. of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Independence</td>
<td>.896</td>
<td>4</td>
</tr>
<tr>
<td>Audit Composition</td>
<td>.949</td>
<td>7</td>
</tr>
<tr>
<td>Audit technical requirements</td>
<td>.953</td>
<td>8</td>
</tr>
<tr>
<td>Overall Reliability</td>
<td>.976</td>
<td>19</td>
</tr>
</tbody>
</table>

The overall Cronbach Alpha for the research was .976 which is higher than .7 thus showing the research instrument is reliable to be used in solving the research problem.

Validity was measured using the methodology proposed by Crocker (1986) which calculates validity coefficients that identify what percentage of variance in the criterion variable is accounted for by the testing measure, or predictor variable (Golafshani, 2003). The calculation of both reliability and validity was done using the results of the pilot study. The data collected through the pilot survey was used to adjust or modify the questionnaire in order to improve levels of clarity. To test the validity of the study the study adopted the inter-rater validity test. In this test the questionnaires were given to different respondents then their varying responses were face-analysed since different respondents would generally understand the questions differently. Thus, higher degrees of variance in how the respondents approached the questions would generally imply the construct needed some modification.

3.5 Data Analysis

Data collected was analysed using a multiple linear regression and correlation analysis through the SPSS data analysis tool. Descriptive analysis involved the use of frequencies in their absolute and relative forms (percentage). Mean and standard deviations was also used as measures of central tendencies and dispersion respectively. Descriptive data was presented using tables, charts and graphs as deemed appropriate. Inferential statistics were presented using tables and other infographics. Correlation analysis was used to describe the degree to which the independent variables are related to employee engagement. A multivariate analysis of the influence of performance measurement on
employee engagement was performed by estimating a linear regression as shown by the regression equation below:

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon \]

Where:

\( Y \) = Dependent variable (Audit Committee Effectiveness)

\( \beta_0 \) = the model intercept

\( \beta_1 - \beta_4 \) = Coefficient of independent variables

\( X_1 - X_4 \) (\( X_1 \) – Independence, \( X_2 \) – Composition, \( X_3 \) – Technical Skills, \( X_4 \) – Prudential Requirements)

\( \epsilon \) = Error Term
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This Chapter presents research findings unearthed after data analysis, interpretation and presentation. It is organized according to the research objectives namely influence of audit committee independence on the performance of commercial banks in Kenya; influence of audit committee composition on the performance of commercial banks in Kenya; effect of audit committee technical skills on the performance of commercial banks in Kenya; and finally, the moderating effect of prudential requirements on the relationship between audit committee and performance of commercial banks.

4.2 Questionnaire Return Rate and Respondents’ background

4.2.1 Response rate
In total, 60 questionnaires distributed among commercial banks in the selected surroundings. With the help of the commercial banks’ staff and management, 45 questionnaires were recovered representing 75% of the questionnaire return rate. 100% questionnaire return rate could not be ascertained because it was hard to reach out some places due lack of enough time and a lot of expenses like transport. According to Mugenda and Mugenda (2003), a response rate of 70% and over is excellent for analysis and reporting on the opinion of the entire population.

4.2.2 Respondents’ Background
In the administered questionnaire, the respondents were expected to give brief general information about themselves. The information was on: Gender, Age, and the level of Education, position and length of service. These variables are important since they determine the interactions that exist between the audit committees and commercial banks. The age aspect denotes the level of experience with interactions in the audit committee sector; while, gender matters, Education, position and service length denote the level of awareness about the audit sector, attitudes and Consciousness about the sector.

4.2.2.1 Gender
The respondents were asked to indicate their gender. 23 were of the Male Gender which represented 51% while 22 were of the Female Gender which represented 49%.
### Table 4.1: Gender

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>23</td>
<td>51%</td>
</tr>
<tr>
<td>Female</td>
<td>22</td>
<td>49%</td>
</tr>
</tbody>
</table>

#### 4.2.2.2 Age of Respondents

Age was also another variable that was assessed based on the four Categories: Between 18-25, between 25-35, between 35-50 and those that are above 50. The reason for the Categorization is because 18-25 are perceived as young youths, 25-35 perceived as grown up youths, those between 35-50 perceived as Adults. As a result, 16% were between 18 and 25, 35% were between 25 and 35, and 49% were Over 35 years.

![Age Distribution](image)

#### Figure 4.1: Age

#### 4.2.2.3 Level of Education

The respondents were asked to indicate their levels of education. 22% had a college diploma, 45% had attained a university degree which constituted the largest Number of the respondents. Those who had attained a master’s degree were significantly lower than those who had attained university degrees only with a percentage of 20%. Those who had attained Doctorate Honours were 13% which was the least number of the respondents.
Table 4.2: Level of Education

<table>
<thead>
<tr>
<th>Level of Education</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>College Diploma</td>
<td>10</td>
<td>22%</td>
</tr>
<tr>
<td>Degree</td>
<td>20</td>
<td>45%</td>
</tr>
<tr>
<td>Masters</td>
<td>9</td>
<td>20%</td>
</tr>
<tr>
<td>Post Graduate/Doctorate</td>
<td>6</td>
<td>13%</td>
</tr>
</tbody>
</table>

4.2.2.4 Position Held

The respondents were asked to indicate the position they held in the audit committees. 5 were Chairmen which represented 11%, 6 were secretaries which represented 13% while the majority 34 were members only which represented 76%.

Table 4.3: Position Held

<table>
<thead>
<tr>
<th>Position Held</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>5</td>
<td>11%</td>
</tr>
<tr>
<td>Secretary</td>
<td>6</td>
<td>13%</td>
</tr>
<tr>
<td>Member</td>
<td>34</td>
<td>76%</td>
</tr>
</tbody>
</table>

4.2.2.5 Years of Service

Duration of service was also another variable that was assessed based on four Categories: Between 1-3 years, between 3-5, between 5-8 years and those who have served more than 8 years. The reason for the Categorization is to know the level of experienced gained by each respondent giving more significance to the study. As a result, 13% had served between 1 and 3 years, 36% had served between 3 and 5 years, and 24% had served between 5 and 8 years and 27% had over 8 years of service.
Table 4.4: Years of Service

<table>
<thead>
<tr>
<th>Duration of Service</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-3 years</td>
<td>6</td>
<td>13%</td>
</tr>
<tr>
<td>3-5 years</td>
<td>16</td>
<td>36%</td>
</tr>
<tr>
<td>5-8 years</td>
<td>11</td>
<td>24%</td>
</tr>
<tr>
<td>More than 8 years</td>
<td>12</td>
<td>27%</td>
</tr>
</tbody>
</table>

4.3 Effect of Audit Committee Independence on Performance of Commercial Banks in Kenya

The respondents were requested to indicate their extent of agreement concerning the statements on audit committee independence and performance of commercial banks. The responses were placed on a five Likert scale ranging from 1 (strongly agree) to 5 (strongly disagree). The findings presented in Table 4.5.
Table 4.5: Effect of Audit Committee Independence on Performance of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>sd</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Moderate</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Express audit committee independence ensures biasness in undertaking the responsibilities of the committee.</td>
<td>1.9</td>
<td>0.19</td>
<td>12</td>
<td>22</td>
<td>5</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Independence of the audit committee fosters effective feedback and control of their functions</td>
<td>1.3</td>
<td>0.29</td>
<td>17</td>
<td>28</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee independence fosters objectivity and integrity in the committee functions</td>
<td>1.6</td>
<td>0.21</td>
<td>14</td>
<td>22</td>
<td>9</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee independence fosters impartiality in the committee functions</td>
<td>1.5</td>
<td>0.25</td>
<td>14</td>
<td>26</td>
<td>5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee independence fosters the financial reports quality and accountability in the public sector</td>
<td>1.3</td>
<td>0.23</td>
<td>17</td>
<td>22</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to Independence of Audit committee and financial performance of commercial banks in Kenya. From the findings the study established that majority of
the respondents strongly agreed that an audit committee must be independent of both the personnel and operational activities of an organization. An independent audit committee fosters effective feedback and control of their functions, as shown by a mean of 1.30 in each case, others agreed that Audit committee independence fosters objectivity and integrity in the committee functions. Independence is the essence of auditing as shown by a mean of 1.50 in each case The integrity of the auditor’s opinion, conclusion and recommendations would be suspect as shown by a mean of 1.60. Audit committee independence ensures biasness in undertaking the responsibilities of the committee as shown by mean of 1.90.

The results showed that the coefficient of Pearson correlation between audit independence and the performance of commercial banks was 0.560 while the p value was 0.001. The p value was less than 0.1 suggesting that performance of commercial banks was significantly related with audit committee independence in Kenya. A unit increase audit committee independence would lead to increase in performance of commercial banks by a factor of 0.560.

From the findings, the co-efficient of determination was 0.554, an indication that there was variation of 55.4% on financial performance of commercial banks due to changes in independence of the audit committee at 95% confidence interval. This shows that 55.4% changes in financial performance of commercial banks could be accounted for by changes in independence of the audit committee. The study also established that there is strong positive relationship between performance of commercial banks and in independence of the audit committee as shown by correlation coefficient of 0.919.

Analysis of variance (ANOVA) is a collection of statistical models used to analyse the differences among group means and their associated procedures (such as "variation" among and between groups). The ANOVA results shows that the regression model has a margin of error of p = .001. This indicates that the model has a probability of 0.1% of giving false prediction. This therefore points to the significance level of the model.
Table 4.6: Regression

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R squared</th>
<th>Adjusted R squared</th>
<th>Std Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.919</td>
<td>.560</td>
<td>.554</td>
<td>0.001</td>
</tr>
</tbody>
</table>

4.4 Effect of Audit Committee Composition on Performance of Commercial Banks in Kenya

The respondents were requested to indicate their extent of agreement concerning the statements on audit committee membership composition and performance of commercial banks. The responses were placed on a five Likert scale ranging from 1 (strongly agree) to 5 (strongly disagree). The findings were as in table 4.7.
Table 4.7: Effect of Audit Committee Composition on Performance of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Sd</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Moderate</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit committee composition fosters the effectiveness of the audit function.</td>
<td>1.45</td>
<td>0.22</td>
<td>14</td>
<td>22</td>
<td>8</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee composed of members with leadership experience enhance the independence and efficiency of the committee</td>
<td>1.25</td>
<td>0.26</td>
<td>17</td>
<td>25</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee composed of independent advisers ensures biasness in reporting and undertaking the audit functions</td>
<td>1.45</td>
<td>0.28</td>
<td>12</td>
<td>27</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rotation of audit committee members fosters credibility in the functions of committee</td>
<td>1.3</td>
<td>0.22</td>
<td>18</td>
<td>22</td>
<td>5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>The audit tenure of committee members enhances the audit quality in the public sector.</td>
<td>1.4</td>
<td>0.30</td>
<td>14</td>
<td>28</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>The size of the audit committee enhances the quality of the audit work</td>
<td>1.90</td>
<td>0.20</td>
<td>10</td>
<td>20</td>
<td>4</td>
<td>10</td>
<td>1</td>
</tr>
</tbody>
</table>
The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to Audit committee composition and performance of commercial banks in Kenya. From the findings the study established that majority of the respondents strongly agreed that an audit committee must be well and efficiently composed in order to increase performance. The size of the audit committee enhances the quality of work had the highest mean of 1.9. Respondents vastly agreed that Rotation of audit committee members’ fosters credibility in the functions of committee with a mean of 1.3. The audit tenure of committee members enhances the audit quality in the public sector had a mean of 1.3 and standard deviation of 0.3 Majority of the members also agreed that Audit committees are composed of members with leadership experience thus enhancing the independence and efficiency of their respective committees. This is represented by the lowest mean of 1.25 and a standard deviation of 0.26.

The results showed that the coefficient of Pearson correlation between audit composition and the performance of commercial banks was 0.295 while the p value was 0.042. The p value was less than 0.1 suggesting that audit committee composition was significantly related with performance of commercial banks in Kenya. A unit increase in audit committee composition would lead to increase in performance of commercial banks by a factor 0.295.

From the findings, the co-efficient of determination was 0.304, an indication that there was variation of 30.4% on financial performance of commercial banks due to changes in audit committee composition at 95% confidence interval. This shows that 30.4% changes in financial performance of commercial banks could be accounted for by changes in audit committee composition. The study also established that there is strong positive relationship between performance of commercial banks and in audit committee composition as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .004. This indicates that the model has a probability of 0.4% of giving false prediction.
Table 4.8: Regression

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R squared</th>
<th>Adjusted R squared</th>
<th>Std Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.919</td>
<td>.295</td>
<td>.308</td>
<td>0.004</td>
</tr>
</tbody>
</table>

4.5 Effect of Audit Committee Technical Skills on Performance of Commercial Banks  

The respondents were requested to indicate their extent of agreement concerning the statements on audit committee members’ technical skills and performance of commercial banks. The responses were placed on a five Likert scale ranging from 1 (strongly agree) to 5 (strongly disagree). The findings were as shown below.
Table 4.9: Effect of Audit Committee Technical Skills on Performance of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Sd</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Moderate</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit committees composed of financial experts enhance the credibility and quality of the audit reports.</td>
<td>1.15</td>
<td>0.23</td>
<td>23</td>
<td>10</td>
<td>12</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee members with professional qualification foster effective monitoring which reduces malpractices in the industry</td>
<td>1.55</td>
<td>0.30</td>
<td>12</td>
<td>30</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Experienced audit committee members leads to effective operations within the committee</td>
<td>2.0</td>
<td>0.20</td>
<td>10</td>
<td>20</td>
<td>6</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Training of audit committee members leads to effective and efficient undertaking of their responsibility</td>
<td>1.45</td>
<td>0.22</td>
<td>14</td>
<td>20</td>
<td>11</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Personal attributes and values of the audit committee members enhance the functional competency of the committee</td>
<td>1.7</td>
<td>0.24</td>
<td>16</td>
<td>22</td>
<td>2</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to the level of Audit committee technical skills and performance of commercial banks in Kenya. From the findings the study established that majority of the respondents strongly agreed that audit committee personnel must possess the technical skills to achieve maximum performance.

Majority of the respondents agreed that Audit committee members with professional qualification foster effective monitoring which reduces malpractices in the industry as
represented by a low mean of 1.55. Training of audit committee members leads to effective and efficient undertaking of their responsibility had the lowest mean of 1.45 which indicates that training is an important factor in enhancing technical skills. Respondents were torn on the fact that presence of experienced audit committee members leads to effective operations within the committee as shown by a high mean of 2.0.

The results showed that the coefficient of Pearson correlation between audit committee technical skills and the performance of commercial banks was 0.111 while the p value was 0.099. The p value was less than 0.1 suggesting that audit committee technical skills was significantly related with performance of commercial banks in Kenya.

From the findings, the co-efficient of determination was 0.120, an indication that there was variation of 12% on financial performance of commercial banks due to changes in audit committee technical skills at 95% confidence interval. This shows that 12% changes in financial performance of commercial banks could be accounted for by changes in audit committee technical skills. The study also established that there is strong positive relationship between performance of commercial banks and in audit committee composition as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .0008. This indicates that the model has a probability of 0.08% of giving false prediction.

Table 4.10: Regression

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R squared</th>
<th>Adjusted R squared</th>
<th>Std Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.919</td>
<td>.111</td>
<td>.120</td>
<td>0.0008</td>
</tr>
</tbody>
</table>

4.6 Effect of Audit Committee Prudential Requirements on Performance of Commercial Banks

The respondents were requested to indicate their extent of agreement concerning the statements on audit committee members’ prudential requirements and performance of commercial banks. The responses were placed on a five Likert scale ranging from 1 (strongly agree) to 5 (strongly disagree). The findings were as shown below.
Table 4.11: Effect of Audit Committee Prudential Requirements on Performance of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>sd</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Moderate</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular meetings of the audit committee enhances the performance of their role.</td>
<td>1.45</td>
<td>0.24</td>
<td>26</td>
<td>10</td>
<td>8</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Audit committee meetings that are not subject to board influence enhance the effectiveness of the committee functions</td>
<td>2.4</td>
<td>0.21</td>
<td>18</td>
<td>9</td>
<td>4</td>
<td>12</td>
<td>2</td>
</tr>
<tr>
<td>Availability of formal meeting calendar among audit committee members enhances the effectiveness of the committee</td>
<td>2.20</td>
<td>0.32</td>
<td>10</td>
<td>10</td>
<td>6</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Planning of audit committee meetings reduces manipulation and risks of board interference</td>
<td>2.0</td>
<td>0.20</td>
<td>18</td>
<td>14</td>
<td>5</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>Control of the audit committee agenda by the members fosters the attainment of the committee responsibilities</td>
<td>2.5</td>
<td>0.21</td>
<td>8</td>
<td>10</td>
<td>9</td>
<td>11</td>
<td>2</td>
</tr>
</tbody>
</table>

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to the level of Audit committee prudential requirements and performance of commercial banks in Kenya.

Majority of the audit committee members agreed that regular meetings of the audit committee enhances the performance of their role as shown by the low mean of 1.45. Audit committee meetings that are not subject to board influence enhance the effectiveness of the committee functions had a mean of 2.4. The highest mean in this category was Control of the audit committee agenda by the members fosters the attainment of the committee responsibilities with a mean of 2.5.
The results showed that the coefficient of Pearson correlation between audit committee prudential requirements and the performance of commercial banks was 0.091 while the p value was 0.733. The p value was greater than 0.1 suggesting that audit committee prudential requirements was not significantly related with performance of commercial banks in Kenya.

From the findings, the co-efficient of determination was 0.093, an indication that there was variation of 9.3% on financial performance of commercial banks due to changes in prudential requirements at 95% confidence interval. This shows that 9.3% changes in financial performance of commercial banks could be accounted for by changes in prudential requirements. The study also established that there is strong positive relationship between performance of commercial banks and prudential requirements as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .077. This indicates that the model has a probability of 7.7% of giving false prediction.

Table 4.12: Regression

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R squared</th>
<th>Adjusted R squared</th>
<th>Std Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.919</td>
<td>.091</td>
<td>.093</td>
<td>0.0773</td>
</tr>
</tbody>
</table>
CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
The chapter presents the summary of findings, conclusions drawn from the data findings. In addition, it presents the recommendations of the study. All this had been geared towards achieving the objectives of the study.

5.2 Summary of the Findings
The purpose of this study was to examine the relationship between audit committee effectiveness and performance of commercial banks in Kenya. Specific objectives pursued were: to examine the influence of audit committee independence on the performance of commercial banks in Kenya; to determine the influence of audit committee composition on the performance of commercial banks in Kenya; to find out the effect of audit committee technical skills on the performance of commercial banks in Kenya; and to determine the moderating effect of prudential requirements on the relationship between audit committee and performance of commercial banks.

The study was a case analysis of commercial banks in Kenya. The methodology used was a descriptive study focusing on process of implementation and the results thereof. The case was used in order to increase the likelihood of high quality data but not necessarily as an object of interest in its own right. The data and information was collected using questionnaires. The target population of the study consisted of the members of the audit committee who made a target population of 210 respondents. The sample size of 60 respondents was generated by random sampling. Data was analysed through descriptive statistics using Statistical Package for Social Scientists (SPSS) in order to give quantifiable statistics and results done with the help of Microsoft Office Excel programme and presented in pie charts, bar graphs and tables.

In terms of the independence of Audit committee and financial performance of commercial banks in Kenya, the study shows established that majority of the respondents strongly agreed that an audit committee must be independent of both the personnel and operational activities of an organization. An independent audit committee fosters effective feedback and control of their functions, as shown by a mean of 1.30 in each case, others agreed that Audit committee independence fosters objectivity and integrity in
the committee functions. Independence is the essence of auditing as shown by a mean of 1.50 in each case. The integrity of the auditor’s opinion, conclusion and recommendations would be suspect as shown by a mean of 1.60. Audit committee independence ensures biasness in undertaking the responsibilities of the committee as shown by mean of 1.90.

The results showed that the coefficient of Pearson correlation between audit independence and the performance of commercial banks was 0.560 while the p value was 0.001. The p value was less than 0.1 suggesting that performance of commercial banks was significantly related with audit committee independence in Kenya. A unit increase audit committee independence would lead to increase in performance of commercial banks by a factor of 0.560.

The co-efficient of determination was 0.554, an indication that there was variation of 55.4% on financial performance of commercial banks due to changes in independence of the audit committee at 95% confidence interval. This shows that 55.4% changes in financial performance of commercial banks could be accounted for by changes in independence of the audit committee. The study also established that there is strong positive relationship between performance of commercial banks and in independence of the audit committee as shown by correlation coefficient of 0.919.

The study also established that majority of the respondents strongly agreed that an audit committee must be well and efficiently composed in order to increase performance. The size of the audit committee enhances the quality of work had the highest mean of 1.9. Respondents vastly agreed that Rotation of audit committee members’ fosters credibility in the functions of committee with a mean of 1.3. The audit tenure of committee members enhances the audit quality in the public sector had a mean of 1.3 and standard deviation of 0.3. Majority of the members also agreed that Audit committees are composed of members with leadership experience thus enhancing the independence and efficiency of their respective committees. This is represented by the lowest mean of 1.25 and a standard deviation of 0.26.

The results showed that the coefficient of Pearson correlation between audit composition and the performance of commercial banks was 0.295 while the p value was 0.042. The p value was less than 0.1 suggesting that audit committee composition was significantly
related with performance of commercial banks in Kenya. A unit increase in audit committee composition would lead to increase in performance of commercial banks by a factor 0.295. The co-efficient of determination was 0.304, an indication that there was variation of 30.4% on financial performance of commercial banks due to changes in audit committee composition at 95% confidence interval. This shows that 30.4% changes in financial performance of commercial banks could be accounted for by changes in audit committee composition. The study also established that there is strong positive relationship between performance of commercial banks and in audit committee composition as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .004. This indicates that the model has a probability of 0.4% of giving false prediction.

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to the level of Audit committee technical skills and performance of commercial banks in Kenya. From the findings the study established that majority of the respondents strongly agreed that audit committee personnel must possess the technical skills to achieve maximum performance. Majority of the respondents agreed that Audit committee members with professional qualification foster effective monitoring which reduces malpractices in the industry as represented by a low mean of 1.55. Training of audit committee members leads to effective and efficient undertaking of their responsibility had the lowest mean of 1.45 which indicates that training is an important factor in enhancing technical skills. Respondents were torn on the fact that presence of experienced audit committee members leads to effective operations within the committee as shown by a high mean of 2.0.

The results showed that the coefficient of Pearson correlation between audit committee technical skills and the performance of commercial banks was 0.111 while the p value was 0.099. The p value was less than 0.1 suggesting that audit committee technical skills was significantly related with performance of commercial banks in Kenya. The co-efficient of determination was 0.120, an indication that there was variation of 12% on financial performance of commercial banks due to changes in audit committee technical skills at 95% confidence interval. This shows that 12% changes in financial performance of commercial banks could be accounted for by changes in audit committee technical skills. The study also established that there is strong positive relationship between
performance of commercial banks and in audit committee composition as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .0008. This indicates that the model has a probability of 0.08% of giving false prediction.

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to the level of Audit committee prudential requirements and performance of commercial banks in Kenya. Majority of the audit committee members agreed that regular meetings of the audit committee enhances the performance of their role as shown by the low mean of 1.45. Audit committee meetings that are not subject to board influence enhance the effectiveness of the committee functions had a mean of 2.4. The highest mean in this category was Control of the audit committee agenda by the members fosters the attainment of the committee responsibilities with a mean of 2.5.

The results showed that the coefficient of Pearson correlation between audit committee prudential requirements and the performance of commercial banks was 0.091 while the p value was 0.733. The p value was greater than 0.1 suggesting that audit committee prudential requirements was not significantly related with performance of commercial banks in Kenya. The co-efficient of determination was 0.093, an indication that there was variation of 9.3% on financial performance of commercial banks due to changes in prudential requirements at 95% confidence interval. This shows that 9.3% changes in financial performance of commercial banks could be accounted for by changes in prudential requirements. The study also established that there is strong positive relationship between performance of commercial banks and prudential requirements as shown by correlation coefficient of 0.919. The ANOVA results shows that the regression model has a margin of error of p = .077. This indicates that the model has a probability of 7.7% of giving false prediction.

5.3 Discussion
5.3.1 Influence of Audit Committees’ Independence on the Performance of Commercial Banks
The study further established that the rotation of the audit committee members has been practiced where members are not allowed to serve a certain continuous period in one commercial bank increasing independence. This agrees with a study by Baxter & Cotter,
(2009), who stated that it is important for the audit committee to have its own independence for it to execute its duties of financial management in an appropriate manner. If it lacks independence the audit committee may be puppet committee which cannot execute its duties appropriately thus the membership should be rotational to avoid compromising of the members.

The study found that audit committees with independent members have been found to be more effective on performance compared to those with fewer members. This agrees with a study by Bond and Dent (2008) who stated that audit committee with many members have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background that results in the individual's financial sophistication, including service as a chief executive officer, chief financial officer, or other senior position with financial oversight responsibilities or otherwise satisfy standards for financial expertise required for audit committees of companies.

The study shows that audit committee independence fosters objectivity and integrity in the committee functions. Stewart and Longley, (2012), found that an audit committee must be independent to contribute to the integrity of the financial reporting process. It can help reinforce a culture with zero tolerance for fraud. The combination of independent oversight and the technical expertise of audit committee members enhance accountability (Stewart & Longley, 2012).

The study further revealed that an audit committee must be independent of both the personnel and operational activities of an organization, the audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes, each bank should have formalised principles of internal audit providing for its position and powers in the framework of the bank, Dent (2008) stated that Independence is the essence of auditing, the integrity of the auditor’s opinions, conclusions and recommendations would be suspect thus auditors may not have a conflict of interests with the bank and finally that independence is necessary for the effective achievement of the function and objective of audit.
5.3.2 Influence of Audit Committee Composition on the Performance of Commercial Banks

The findings of the study indicate that the audit committee of the company should have adequate staff that is qualified and experienced. This is in line with earlier studies of Sabari (2003) and Dandago (2000) who concluded that the audit committee should be properly organized, adequately staffed and equipped to be able to effectively perform its functions. However, Sunday (2003), argued that the audit function’s mandate depends upon the size, structure and management of the organization. Therefore, it is different for each organization.

The composition of the audit committee is fundamental to facilitate the oversight of the organizations accountability and monitoring in order to make room for improvement whenever and wherever it is identified. Audit committees should be formally constituted to ensure that they have a clear relationship with the boards to whom they are answerable and to whom they should report regularly. Membership should be confined to the non-executive directors of the company and a majority of the nonexecutives serving on the committee should be independent (Dandago, 2000). The audit committee’s duties should be determined in the light of the company’s needs (Sunday, 2003). Membership of an audit committee is a demanding task requiring commitment, training and skill. The directors’ concerned need to have sufficient understanding of the issues to be dealt with by the committee in order to take an active part in its proceedings. This is why committees should, if it is appropriate and within their authority, be able to invite outsiders with relevant experience to attend meetings (Sunday, 2003).

From the findings, the performance of the audit committee was determined by the number of audit committee members. These variables have been tested in previous studies conducted by Anderson et al, (2004), for example, found that smaller boards are associated with higher quality monitoring. He shows that companies with smaller boards could shape the CEO for a better more disciplined in the case of poor performance, to give executives a lower level of total compensation and is also associated with higher market valuation. Similarly, the expectation that the problem cannot be prevented; increased the effective function of the large audit committee to spot potential problems in financial reporting. In addition, if the size of a team is large, individual members may be more vulnerable to the pressures and more subject to follow the others’ opinion without
giving another argument. In this case, the audit committee members are not likely willing to question the potential errors in the accounting reports of the internal review process, which in turn can lead to a greater chance of presenting again later.

Conversely a small team will facilitate the exchange of information in the firm and a better discussion between members, to assist management to identify potential errors in financial reporting and reduce the incidence of restatement of the minimum size requirements. A large committee may suffer from the problem of free riders,

Xin et al., (2003) showed that the size of the audit committee and to devote more resources is more likely to oversee financial reporting and internal control systems within a firm hence high performance and facilitate discussions between the audit committee members (DeZoort and Salterio, 2001). Empirical evidence shows that companies with greater audit committee size prefer to suspicious auditor switches (Archambeault and DeZoort, 2001) and more likely to have lower costs of debt (Anderson et al., 2004). Since the exchange, the effect now requires their registrants to have at least three directors on the audit committee, hence a strong relationship between audit committee size and firm performance.

The effect of having a properly constituted audit committee will have a direct impact in how the committee influences the direction of the implementation of good governance practices within the organization. The right committee will influence the organizations to a positive direction and thus, give value for investment, whereas a misguided committee improperly constituted may not be worth its value as the desired performance may not be realized.

5.3.3 Effect of Audit Committee Technical skills on the Performance of Commercial Banks
The study further found that that to a great extent the staff members of the audit committee had the required technical skills for carrying out their role. This agrees with a study by Lang, (2010) who stated that the experience and expertise of audit committee members in accounting and/or financial management is positively related to the quality of financial reporting and timeliness.

At a minimum, the audit committee as a whole should have recent and relevant experience and should possess a collective balance of skills and expert knowledge -
commensurate with the complexity of the organization and the duties to be performed - in financial reporting, accounting and auditing. (BCBS, 2010). It would be expected that audit committee members be highly experienced professionals within their own field of expertise and as a result will undertake professional development and education on an ongoing basis. However, it is still recognized that audit committee members should be given the opportunity to attend training to obtain new skills and/or update their existing skills so that they can effectively contribute to the audit committee functions (Krishnan, 2015).

The training required will depend on the background of each committee member and should be targeted to assist members in fulfilling their role on the audit committee and enhance their participation in their duties. The training performed should incorporate such areas of auditing as new and revised developments in corporate governance, financial reporting or relevant legislative updates, and/or industry specific areas (Krishnan, 2015). This would ensure that all audit committee members are well informed and are up to date in matters that concern the task that they are charged to undertake, equipping and preparing them for efficient service provision and result oriented output in their assignment. The effect of this training would result in producing knowledgeable committee members well-furnished to carry out their duties effectively and efficiently, thus, rendering productive service to the organization and ensuring that the required standards are attained by the organization due to their hawk eyed monitoring processes to which they will have fully committed themselves to its implementation (Krishnan, 2015).

5.3.4 Moderating effect of Prudential Requirements on the Relationship between Audit Committee and Performance of Commercial Banks

The study also established that audit committee meetings are held at least 3-6 times in a year in specified intervals increasing performance of the commercial banks. This agrees with a study by Kent, (2005) who argued that audit committee meeting should be held regularly to ascertain the financial performance of the ministries. This is so because an auditor's duty is to give a fair and truthful view of a client's set of the company accounts at regular intervals. Demands on the directors’ time have multiplied, as evidenced by recent survey studies indicating a significant increase in the number and duration of audit committee meetings.

According to a 2012 survey of KPMG’s ACI, 40% of audit committees expected to meet in person or via conference call eight or more times in 2011 (KPMG, 2012). Further,
Spencer Stuart’s Board Index study (SSBI, 2003) finds that in just one year the number of audit committee meetings reported by S&P 500 companies increased by 46%, from an average of five per year to an average of seven, and 40% are meeting eight or more times a year. The study also reports that the average number of hours, per director, per year spent on board tasks (including meeting, preparation, and travel) was 101 hours, an increase of 12% since the previous year (SSBI, 2003). Consistent with this, other survey studies find that board meetings last longer now, ranging in length from a day and a half to two days (Taube, 2004). Further, audit committees now are meeting with the external auditors much more often and in many cases outside of formal audit committee meetings.

The study established that there are monthly trainings organized for the audit committee members increasing their audit function skills. This agrees with a study by Qin (2007) who asserts that firms with higher quality of earning are more associated with audit committee members who have regular training. Audit committee with high frequency of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance.

Audit committee meetings should be held on a timely and regular basis and their proceedings, recommendations and discussions formally minuted. A meeting agenda should be prepared and distributed sufficiently in advance to enable adequate evaluation by committee members. A detailed agenda and strong chairing is vital in order that committee meetings remain focused. The committee should determine its own agenda. The audit committee should meet at least quarterly, the timing of meetings depending on individual agency processes, audit reporting and financial statement preparation timeframes. For example, the audit committee should meet to review the financial statements before they are certified by the accountable officer or statutory body Chair and the chief finance officer. An annual work plan sets out the activities to be covered by the audit committee. The work plan should allocate the key tasks to be covered at specific meetings to ensure all activities are addressed at the appropriate time during the year and that all key responsibilities are covered. The annual work plan would also allocate appropriate time for a review of the progress of the internal audit function against the audit plan. An analysis of the adequacy of the operational aspects of the audit, for example, staffing, skills and timing, also is desirable. When an audit committee is determining its work plan for the year, the committee should ensure that the plan aligns to
the audit committee’s charter. The audit committee’s charter guides the behaviour and operations of an audit committee on an ongoing basis.

5.3.5 Firms’ Performance
Audit committee effectiveness function was found to have major impact on financial performance which was reaffirmed by Roe (2004), who stated that the audit function evolution is as a result of search for information by interested parties in order to assess performance of others in whom they have vested interest. He additionally argued that interested parties need audit function as a monitoring mechanism as it enforces accountability. A study by KPMG (2007) found that the existence of an audit committee in organizations results in improved performance and helps in undertaking forensic audit in cases of corporate calamities like financial fraud. Thus, audit due to its nature of being a watchdog could protect the organization from the unethical practices and irregularities hence allowing the organization to achieve its objectives of ensuring high levels of productivity and profitability. Barrett (2002) had stated that the audit committee is key in performance improvement. Fadzil et al. (2005) had established that the audit committee helps in increasing shareholders value through running the company efficiently and effectively. Hermanson and Rittenberg (2003) had concurred with these findings that the existence of an effective audit committee is associated with high levels of organizational performance.

The study found that there has been a significant increase in company profits and financial management as a result of audit committee effectiveness in the recent past within commercial banks. This agrees with a study by Beyanga (2011), who argued that an effective auditing service help in revenue collection and financial management, identify ways to improve efficiency and maximize exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the financial performance of an organization.

Finally, the study established that competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes in the commercial banks. This agrees with a study by Ogoro & Simiyu, (2014), who stated that audit committees are required to have a number of characteristics for effective operation in their roles of vetting the integrity of financial statements.
5.4 Conclusion

5.4.1 Independence of Audit Committee and Commercial Banks’ Performance

The findings provide evidence to suggest that the presence of independence among the audit committee positively affect firm performance. In line with the findings of the study, Firms with independent directors on the audit committee are less likely to be involved in financial misreporting hence establish positive investor perception and improved firm performance. Further, the presence of independent auditors reduces the chances of financial distress a company receives with the going concern opinion. In so doing, the independence of the audit committee is able to help the external auditors to maintain their fiduciary without influence from company directors (Carcelle and Neal 1999).

5.4.2 Audit Committee Composition and Performance of Commercial Banks

The findings of the study have also shown that the audit committee composition is positively associated with firm performance. With increased size of the audit committee, firm performance may be expected to decline because of the problem of free riders and the pressure to follow other members’ opinion without considering your argument. However, it can also be argued that large size audit committees can protect and control the process of accounting and finance since there is increased expert advice with increased size of the audit committee. In Conclusion, the audit composition needs to be diverse in order to achieve efficiency.

5.4.3 Audit Committees Technical Skills and Performance of Commercial Banks

The study has shown that audit committee members technical skills is positively associated with performance. It is therefore utmost necessary for firms to re-elect audit committee members with the requisite technical skills to the board because of their vast experience. Also, the presence of audit members with technical skills will also reduce financial misreporting and enhance quality monitoring. As such, having technically skilled audit committee members should be a key priority for firms.

The study concluded that increased audit committee meetings within the financial year actually improved performances within the banks. This is because with increased meetings it keeps the committee members on their toes and are more alert to efficient reporting thus efficiency within the firm.
5.5 Recommendations

5.5.1 Recommendations for Improvements
There is need for the audit committee to continuously update themselves with the changing times and technologies and sharpen their skills. By applying skills to the most critical points, building personal and professional credibility and recognising and responding to the needs, auditors can become indispensable thus speeding good governance and enhancing efficiency of audit committees.

The management of commercial banks should keep organizing training seminars and workshops whereby these audit committee members would be trained frequently by experts either internally or externally. The committee must have sufficient proficiency and training to carry out the tasks assigned to them. The auditor's work must be carefully directed, supervised and reviewed. The amount of supervision required corresponds to the experience and technical skills of the auditor. The supervision however should promote independence.

Commercial Banks should ensure the staff competency, professional auditing and offer guidance needed for audit staff committee, knowledge of auditors on auditing techniques, and efficiency of the auditors. They must also ensure the effectiveness of audit committee operations so as to establish and maintain effective accounting controls, provide reasonable assurance for safeguarding company assets, eliminate corruption and fraud cases, provide consulting services to assist management in implementing of governance processes to improve corporate governance.

5.5.2 Recommendation for Further Studies
The study investigated the audit committee effectiveness and how it affects performance of commercial banks. This research recommends a similar study to be done but concentrate on the parastatals and government ministries. There is also need for a study to be conducted to determine the challenges facing the audit committee in commercial banks, this will help in enhancing the effectiveness of the audit committee in the commercial banks in Kenya and thus positively affect their performance.
REFERENCES


Abu-Azza, W. O. (2012). Perceived Effectiveness of the Internal Audit Function in Libya: A Qualitative study using Institutional and Marxist Theories. *Australia: School of Accounting, Economics and Finance; Faculty of Business Law; University of Southern Q.*


APPENDICES

Appendix I: Questionnaire
The purpose of this questionnaire is to help collect data for a Master’s thesis at USIU University. Please respond by ticking the appropriate box in the blank spaces provided by putting a tick (√) in the box provided that closely matches your view by wiring a number in the box or write your answers in the space provide. Information collected will be treated with strict confidence.

PART A: GENERAL INFORMATION

1. Kindly indicate your gender?
   Male ( )
   Female ( )

2. Kindly tick the box that corresponds to your current age level.
   18-25 years ( )
   26-35 years ( )
   36-50 years ( )
   Above 50 Yrs ( )

3. What role do you play within the audit committee?
   Chairman ( )
   Secretary ( )
   Member ( )

4. Kindly indicate your highest level of education attained.
   Doctorate ( )
   Masters ( )
   Degree ( )
   College Dip ( )

5. How long have you been working at the audit committee?
   1-3 years ( )
   3-5 years ( )
   5-8 years ( )
   Over 8 yrs ( )
PART B: RELATIONSHIP BETWEEN AUDIT COMMITTEE
CHARACTERISTICS AND PERFORMANCE OF COMMERCIAL BANKS IN KENYA

Rate the extent to which you agree with the below statements using any of the following ratings (where; 1 = Strongly agree, 2 = agree, 3 = Neutral, 4 = Disagree, 5 = Strongly Disagree)

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<td>1. Audit Committee Independence</td>
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<td>Express audit committee independence ensures biasness in undertaking the responsibilities of the committee.</td>
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<td>Independence of the audit committee fosters effective feedback and control of their functions</td>
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<td>Audit committee independence fosters objectivity and integrity in the committee functions</td>
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<td>Audit committee independence fosters impartiality in the committee functions</td>
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<td>Audit committee independence fosters the financial reports quality and accountability in the public sector</td>
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<td>2. From your own perspective in what other ways does the audit committee independence influence the performance of commercial banks?</td>
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<td><strong>3. Audit Committee Composition</strong></td>
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<td>Audit committee composition fosters the effectiveness of the audit function.</td>
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<td>Audit committee composed of members with leadership experience enhance the independence and efficiency of the committee</td>
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<td>Audit committee composed of independent advisers ensures biasness in reporting and undertaking the audit functions</td>
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<td>Rotation of audit committee members fosters credibility in the functions of committee</td>
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<td>The audit tenure of committee members enhances the audit quality in the public sector.</td>
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<td>The size of the audit committee enhances the quality of the audit work</td>
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**4. In your opinion, in what other ways does the audit committee composition influence the performance of commercial banks?**

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### 5. Audit Committee Technical Skills

Audit committees composed of financial experts enhance the credibility and quality of the audit reports.

Audit committee members with professional qualification foster effective monitoring which reduces malpractices in the industry.

Experienced audit committee members leads to effective operations within the committee.

Training of audit committee members leads to effective and efficient undertaking of their responsibility.

Personal attributes and values of the audit committee members enhance the functional competency of the committee.

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<td>5. Audit Committee Technical Skills</td>
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<td>Audit committees composed of financial experts enhance the credibility and quality of the audit reports.</td>
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<td>Audit committee members with professional qualification foster effective monitoring which reduces malpractices in the industry.</td>
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<td>Experienced audit committee members leads to effective operations within the committee.</td>
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<td>Training of audit committee members leads to effective and efficient undertaking of their responsibility.</td>
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<td>Personal attributes and values of the audit committee members enhance the functional competency of the committee.</td>
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a. In your opinion, in what other ways does the audit committee technical skills influence the performance of commercial banks?

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<td><strong>6. Audit Committee Prudential Requirements</strong></td>
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<td>Regular meetings of the audit committee enhances the</td>
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<td>performance of their role.</td>
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<td>Audit committee meetings that are not subject to board influence</td>
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<td>enhance the effectiveness of the committee functions</td>
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<td>Availability of formal meeting calendar among audit committee members</td>
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<td>enhances the effectiveness of the committee</td>
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<td>Planning of audit committee meetings reduces manipulation and risks of</td>
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<td>board interference</td>
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<td>Control of the audit committee agenda by the members fosters</td>
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<td>the attainment of the committee responsibilities</td>
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**7. How regular does your audit committee hold meetings annually?**

1-3 times ( )

3-6 times ( )

6-12 times ( )

**8. From your experience, in what other ways are audit committee prudential requirements related to the performance of commercial banks?**

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9. Kindly indicate your level of agreement with the following aspects on audit committees within the commercial banks industry?

Use a scale of 1-3: 1 – low level of agreement; 2- moderate agreement; 3 – Strong agreement

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<th>Strong agreement</th>
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<td>There are wide disparities in the expected performance of audit committee members in the industry</td>
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<td>There is high criticism on the role played by audit committees in fostering better corporate governance in the industry</td>
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<td>The public has extremely high expectations of the audit committees in the industry</td>
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<td>The audit committee should be responsible for any corporate governance lapses within commercial banks</td>
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10. From your experience, what other audit committee characteristics influence the performance of commercial banks

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11. What are the challenges faced by audit committees in commercial banks?

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12. In your opinion what are the solutions to these challenges?

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