AUDIT FIRM CHARACTERISTICS AND AUDIT QUALITY FOR FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE IN KENYA

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ABSTRACT

There have been numerous financial scandals and audit reporting failures in both public and private organizations some of which are listed in the NSE which has led Companies in various sector of the economy to experience financial distress; that is circumstances in which a company cannot meet its current obligations using operating cash flows and it is therefore faced with the need to employ corrective measures. Such distresses have been occasioned by professional misconduct while handling financial accounts and consequently raising doubts on auditing profession. Consequently, a lot of questions have been raised about the auditing profession in Kenya. Much of the concerns are about reduced quality audit and independence of auditors and especially the Big 4. This study therefore sought to establish the effect of audit firm characteristics on audit quality of firms listed in the Nairobi Securities Exchange. This study aimed to investigate the joint effect of audit firm tenure, auditor reputation, auditor independence and auditor professional competence and due care on quality audit of firms listed in the Nairobi Securities Exchange in Kenya. The study was anchored on the agency theory, role theory and audit expectation gap and the signaling effect theory. A descriptive research design was used. The researcher used primary and secondary data for a period of five years between 2011 and 2015. Primary data was collected using structured questionnaires issued to selected respondents and secondary data was derived from audited and published financial statement for the listed companies in the Nairobi Securities Exchange and the NSE, CMA and other relevant websites and recorded in a data collection sheet. A population of 67 listed firms was the object of study out of which 33 firms were selected using purposive sampling technique. This sample was approximately 50%. Inferential statistics like correlation analysis and multiple regression analysis were used to measure and analyze the results of the study which was analyzed and presented in form of statements and tables. The researcher applied high ethical standards to ensure no information is misrepresented and citations made accordingly. SPSS package version 7.0 was used to analyze the data. The findings and conclusions focused on effects the independent variables have on quality audit for selected firms listed in the NSE in Kenya. The recommendations thus enables audit firms, clients, all users of financial information and investors to have in-depth knowledge of firm characteristics that allow objective financial reporting and sound investment decision making. The study found that firms allowed quality audit work to be carried out because of strong commitment and dedication to management role and profession in the organization, that management ensured that there was no personal relationship with the auditors that would lead to familiarity threats and compromise their independence, that duration in years and rotation of auditor or lead partner greatly affect quality audit for firms and that auditors have the required academic qualifications to be professional auditors. The study concluded that audit tenure activities had the greatest effect on the influence of stakeholder activities on audit quality, followed by auditor reputation, then auditor independence then auditor professional competence while disciplinary measures had the least effect on audit quality. The study recommends that there is need to increase the proportion of independent auditors since an increase in their number reduces the chances of financial misreporting and leads to positive perception by investors and that there should be high level of professionalism by the audit firms.

Key Words: *audit firm characteristics, audit quality, firms listed, Nairobi Securities Exchange, Kenya*

INTRODUCTION

As a major component of sound corporate governance in an organization, high quality external auditing is done by organizations. However, relatively little is known on what determines audit quality. The many recent financial scandals on firms in Kenya provide a ground for the need to investigate the joint effect of audit tenure, auditor reputation, auditor independence and auditor professional competence and due care on quality audit for listed firms in the NSE (Mwangi, 2014).

Whenever management interests are not in order with that of shareholders, an organization contracts external auditor (Barzegar & Salehi, 2012). The agency theory states that an agency relationship will exist when an agent is contracted to act on behalf of a principal. The relationship is built on certainty that the agent will perform his duties as delegated in a manner as if the principal was present and acting alone.

Professional competence, due diligence, caution and related skills are expected from the auditor while performing his duties. An auditor is expected to state the status of an entity audited through statements in his final report. He may employ various methods to gather evidences and finally express an opinion which likely affects the quality of his audit report which in this case is the audit quality (Clinch, 2010) .

The literature focused on factors that were found to affect audit quality. These factors were four (4) among many others. They included; audit tenure, auditor reputation, auditor independence and auditor professional competence and due diligence. Under audit tenure, it is argued that whenever an auditor serves an audit firm for a long period, the auditors are in greater pressure to provide quality. Secondly, high reputation auditors have more incentive to protect their reputation thereby less tendency to be compromised by clients' actions. Also, the independence of an audit is important as it enables an auditor to come up with expert opinion that will benefit the client and third parties through recommendations for improvement. Lastly, the lead of Lennox (2018), argued that large auditors have better reputation and therefore more incentive to issue accurate reports. Three main hypotheses were used to explain the quality audit phenomenon: They are Agency Theory by Jones (2016), Role Theory and Audit Expectation gap by Oyadonghan (2011) and Information theory which were widely referred to as the three most plausible explanations to audit quality.

Audit Firm Characteristics and Audit quality

Extended audit firm tenure is argued to make auditors less independent due to long relations leading to familiarity with client, thus auditor may bend to client's demands so as to continue receiving future audit fees, Hoyle (1978). Earlier arguments put forth that extended relations between auditor and client and the fear of losing future income and the need to protect their reputations induces auditor to improve audit quality, De Angelo (1981). Since these effects operate in opposite directions, in addition to determination of how each factor affects audit quality independently, it is prudent to consider the joint effect of audit firm characteristics as a whole and not only proxies like audit firm tenure, auditor reputation, auditor independence and auditor professional competence and due care in isolation.

Audit Firm Tenure

Audit tenure implies to the durations or periods of time an audit firm audits a certain client. According to Geiger (2012), when the client and audit firm have an extended relationship, auditor's independence might be threatened. An extended relationship between an organization and an accounting firm might pose threat to independence of an auditor since the auditor is too familiar with the interests of its client's (Congress 1976). This was further explained by Mautz and Sharaf (1961) who explained this situation to be contributed by reluctance and impartiality on the side of an auditor which leads to impaired judgement and interferes with auditors skepticism. Brody & Moscove (2015), suggested that auditor independence and judgement can be maximized by auditor or audit firm rotation.

Audit tenure was measured by dividing the five years (2011 – 2015) period that was analyzed into: (SHORT=0) ;short term tenure if client had been audited by audit firm for 3 years or less, and (LONG =1) if the client had been audited by same auditor for more than 3 years. Previous research results have shown that there exists relationship between audit firm tenure and discretionary accruals as an quality audit proxy. Chedagani (2011), defined proxies as the direct and indirect measures and ideas that people have that may influence quality audit for example financial reporting compliance, quality control review, industry expertise, cost of capital and company size among others. Similarly, (Becker et al 2015) suggested that discretionary accruals are a proxy for earnings quality and audit quality. De las Heras et al, 2012 argued that discretionary accruals implicitly reflect fundamental economic performance. Thus the quality of earnings information in the financial report is able to reflect the audit quality. It is believed that extended relationship of an auditor and client might compromise the quality audit of reports produced by the auditor.

Auditor Reputation

Auditor reputation refers to the perceived corporate image of an auditing firm created from recorded previous performance on audit quality. Previous researchers Shrum and Wuthnow (2011), described auditor reputation as the relative standing or auditor desirability. Pololyn (2013), described reputation as esteem and Dolligner et al., 2016 described it as favourableness. A study by Sucher (2018) suggested that reputation is based upon both practical and technology an audit firm possess and that this reputation only comes with time. However, Aronmwan (2013) argued that it is hard to evaluate what the basis of an auditor's reputation is that amounts to audit quality.

Thus, quality audit is independent of audit firm size and that smaller audit firms are more dependent on few large clients than larger audit firms, De Angelo (2011). As postulated in earlier researches, non-audit fees to be received from clients might act as security for those audit firms whose poor quality audit work results to loss on client. This can be proved on the theory of incentives where auditors are motivated by the incentive they receive, the greater the perceived incentive, the greater the audit quality. This is largely related to the auditors from big audit firms.

Auditor Independence

According to Lindberg and Beck 2014, auditor independence is well referred as the pillar of the auditing profession as it is the foundation of the public's trust. DeAngelo (2011) relates the probability of detection to auditor competence and probability of revelation is associated with auditor independence. He argued that large international accounting firms have established brand reputation and have motives to maintain it by providing high-quality audit, therefore (Jeong & Rho, 2014) concluded that bigger auditors become more independent when there is no financial affiliation with clients. This independence provides big auditors with stronger negotiation stance with their clients compared with smaller audit firms (Nelson, Elliott &Tarpley, 2012).

Other prior studies by Alim, Trisni, & Lilik, 2018 and Windsor & Warning-Rasmussen, 2013 had shown that quality audit is positively affected by auditor independence thus a directly proportional relationship. It therefore follows that auditor independence is directly proportional to quality audit as the auditor carries out his or her work freely and objectively. Independence requires integrity and an objective approach to the audit process. In addition to technical competence, auditor independence is the most important factor in establishing the credibility of the audit opinion. This objectivity will not be met if audit report users conclude that the auditor may have been influenced to act differently by other parties like company directors or personal ambitions.

There are two general types of Independence. The first is the Independence of the internal auditor which means independence from parties whose interests might be harmed by the results of an audit. Specific internal management issues include inadequate risk management, inadequate internal controls, and poor governance and Secondly, Independence of the external auditor which means freedom from parties interested in particular results published in financial statements of an entity. This helps give guidance on independence from suppliers, clients, third parties et cetera (Schuer, 2012).

Auditor Professional Competence and Due Care

According to the Accountants Act (2012) and ICPAK code of ethics section 100.4, which touches on professional competence and due care, a professional accountant or auditor has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.

ICPAK Code of Ethics Section 100.11 and 100.12 further emphasizes that professional competence and due care are regarded as safeguards that deter unethical behavior and promote quality audit to a firm since it enhances auditors capacity and capability. It further promotes safeguards through continuing professional development requirements, peer reviews, regulatory monitoring and disciplinary procedures and communication of information produced by a professional accountant which all amount to quality audit to firms listed in the Nairobi Securities Exchange market. ICPAK Code of Ethics Section 130, also emphasizes that competent professional services that result to quality audit is to be achieved by auditors when they exercise sound judgment and apply professional knowledge and skill in the performance of such service. Therefore, they must strive to attain professional competence and maintain the same professional competence by acting diligently in their duties and applying technical and professional standards in their services. This will no doubt enhance confidence of users and will over and above resonate to quality of an audit.

Client Importance and Audit Fees

Client importance refers to the degree of economic dependence an audit firm has on a particular client in terms of audit fees. Economic dependence is highly influenced when an auditor performs other consultancy services to client such as taxation, accounting, system design, valuation, recruiting and trainings on addition to auditing thereby increasing risk on quality audit caused by financial reliance of auditing firm on a client. Fear of losing additional income causes an auditor to fail to contradict management even in genuine cases. Further being too familiar with management may cause and auditor to lose his or her professional skepticism (Holye, 2015).

According to Hoitash (2018), audit fees paid affects quality audit in several ways. First, clients who pay high audit fees receive high quality audits resulting to high quality reports. However, high fees may compromise auditors' independence because the induced relationship may make an auditor shy away from seeking necessary supporting documents from a client during the audit process for fear of losing revenue hence affecting audit quality. The total audit fees which includes but is not limited to audit expenses such as cost of travel incurred by auditors, audit tax, cost on time spent auditing a client et cetera are measures of economic dependence, and could impact on auditor independence and consequently on audit quality. Client importance is measured by the natural logarithm of Total Audit Fees paid by client to an audit firm for audit services performed.

The Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) was established in 1954 as the Nairobi Stock Exchange, based in Nairobi the capital of Kenya. It was a voluntary association of stockbrokers in the European community registered under the Societies Act in British Kenya. No formal rules or regulations governed the stock broking activities therefore trading was on mere gentleman's agreement with set standard commissions. At the onset, stock broking was a by-the-way business conducted by professionals like accountants, auctioneers, estate agents and lawyers who met to exchange prices while socializing because they were engaged in other specialties. Over the years, several changes occurred which included delisting of companies established in East Africa that is Tanzania and Uganda, privatization of NSE, establishment of CMA to govern and regulate the stock market, setting up a computerized delivery and settlement system (DASS) and incorporation of Central Depository and Settlement Corporation (CDSC) Limited among others.

Currently there are sixty seven (67) listed firms at the NSE out of which 11, are banking, 7, Agricultural, 3, Automobiles and Accessories, 12, Commercial and Services, 5, Construction and Allied, 5, Energy and Petroleum, 6, Insurance, 5, Investment, 1, Investment Services i.e. NSE, 10, Manufacturing and Allied, 1, Telecommunication and Technology, 1, Real Estate Investment Trust and 1, Exchange Traded Fund (www.nse.co.ke). The secondary data that is available in audited annual reports at the Nairobi Securities Exchange (NSE), Capital Markets Authority (CMA), and the various company websites, financial reports, financial bulletins and various financial Acts and Regulations necessitates the analysis of these listed firms.

STATEMENT OF THE PROBLEM

There have been numerous financial scandals and audit reporting failures in both public and private organizations some of which are listed in the NSE which has led Companies in various sector of the economy to experience financial distress; that is circumstances in which a company cannot meet its current obligations using operating cash flows and it is therefore faced with the need to employ corrective measures (Wruck 2015). Such distresses have been occasioned by professional misconduct while handling financial accounts and consequently raising doubts on auditing profession. For example, recent corporate scandals in Kenya such as Deloitte & Touche an external auditor which was reported for professional misconduct in handling financial accounts of Mumias Sugar, Tusky Supermarket, the Collapsed Dubai Bank and Chase Bank. Ernst & Young also a big reknown audit firm was investigated by Commission for Co-operative Development on the role it played during the acquisition process of Equatorial Commercial Bank by Mwalimu Sacco. Consequently, a lot of questions have been raised about the auditing profession in Kenya. Much of the concerns are about reduced quality audit and independence of auditors and especially the Big 4 audit companies in Kenya which include KPMG, PWC, Delloite and Ernest and Young. Recently, the Institute of Certified Public Accountants of Kenya (ICPAK) enacted new regulations that will require external auditors to deepen disclosure on financial statements by companies (ICPAK, 15), in as much as economics suggests that the concentration of the accounting field is lowering the quality of audits being conducted and there exists very little documented studies on quality audit in Kenya. Having few success stories on quality audit is a matter that may affect stakeholder confident and reduce trading profit in the Nairobi securities market as a whole. Regulatory bodies like the CMA and ICPAK, are also challenged with a duty of regularly monitoring the accounting and auditing profession to ensure high quality work is done on financial statements. This thus dictates regular inspections and even taking disciplinary actions if need be in cases that misrepresentations or creative accounting are cited to users of financial information. Mriwa (2013), measured how audit tenure affected quality audit in commercial banks listed in the Nairobi Securities Exchange (NSE) and concluded that quality audit was affected by the effectiveness of human capital and auditor independence as the period of audit tenure increases. The study also reported that quality audit in banks was low and as tenure increased the quality decreased which was consistent with the research by Simnett and Carey (2006). This however contradicted findings of Yuniatri (2012) who purported that when audit tenure is long, the quality audit increases. Little research has been done on the quality of audit for firms listed in the securities market in developing countries like Kenya. Various countries have changing characteristics in their variables during a period of analysis, and thus the need to study these factors under developing economies. ICPAK has also instituted various reforms that are inclined to improve quality audit and curb audit failures. The researcher is therefore motivated to analyze and bring to light the relationship between audit tenure, auditors reputation, auditors independence and auditors professional competence and due care on audit quality.

GENERAL OBJECTIVE

The main objective of the study was to determine the effect of audit firm characteristics on the quality audit of firms listed in the NSE in Kenya.

SPECIFIC OBJECTIVES

1. To establish the effect of audit firm tenure on quality audit for firms listed in the NSE in Kenya.

2. To establish the effect of auditor reputation on the quality audit for firms listed in the NSE in Kenya.
3. To determine the effect of auditor independence on quality audit for firms listed in the NSE in Kenya.
4. To determine the effect of auditor professional competence on quality audit for firms listed in the NSE in Kenya.

THEORETICAL LITERATURE

Agency Theory

According to Jone (2016), audit is a monitoring tool implemented to address the principal-agent conflict. Agency theory is an economic theory that attempts to explain the imperfections of an agency relationship. Auditors as agents are expected to act in accordance to the agency relationship agreement and thereby provide possible solutions that align issues with respect to financial presentations that may cause conflict between principal and agent. Agency theory suggests that, under an agreement of one or more people (principals) hire someone else (agent) to act on their behalf as well as delegate some decision making authority.

Depending on the principal-agency agreement, the agent performs duties as delegated by the principal. Mistrust between the two parties may be caused by information asymmetries which may in turn lead to principal-agency conflicts. Consequently, the principal resolves to put in place mechanisms to align their interest to that of agents to reduce any opportunistic behavior and the magnitude of information asymmetries (Grant, 2012). The auditor assesses financial statements of a going concern prepared by the principal to determine the financial position of the company as presented by the financial statements in compliance with GAAPs and other applicable standards. The report an auditor produces from audited accounts helps to re-inforce the trust between the various stakeholders.

Inspired Confidence Theory and Policeman Theory

Hayes et al, 2005, Inspired Confidence Theory suggested that when stakeholders demand accountability from management as an exchange from their contribution to the company, audit services are a direct consequence of the participation of outside stakeholders in the financial markets. Thus the management may give biased information and therefore audit of this information is required. This is in support of Hayes et al, 2015, Policeman Theory which restrains the auditor's responsibilities on arithmetical accuracy and on the prevention and detection of fraud. An auditor is expected by public and users of audit reports to perform the audit process in accordance with relevant laws and regulations that govern the audited entity and present an unbiased and independent audit report of his findings. This is in a bid to prevent fraud and encourage management to be prudent and transparent on making decisions on the affairs of an entity (Appah Ebimobowei and Oyadonghan 2011).

As a result of inspired confidence by beneficiaries, public and users of auditor's report, existing expectation gaps perceived by stakeholders are addressed as part of the duties of an auditor in the financial statements. There are also instances, where an auditor falls prey to personal, emotional or financial pressure which cause compromise on his independence resulting to poor audit quality. These theories therefore support the audit quality.

Signaling Effect Theory

According to Aboody & Lev (2000), signaling effect theory is useful for describing behavior when two parties (individuals or organizations) have access to different information. The sender chooses the appropriate means to communicate or signal the other party to enable adequate interpretation. This interpretation is what will enhance sound and beneficial decision making in a firm. An auditor being an agent of the firm should always ensure to convey accurate signals through the information in their audit reports so that correct signal is received by firm's management and shareholders to enhance proper decision making.

Sijpesteijn (2011), stated that internal decision making process improves with data that is more accurate. Investors make key economic decisions based on signals and information that is provided in financial reports. Investors use audited financial information to make investment decisions and assess expected risk-return relationship. For example dividend payout signals to investors about a firm's future earnings and expected future profitability. Investors draw inferences about the firm's internal operating cash flows from the dividend announcement made and the report of the auditor over the financial soundness of the firm.

EMPIRICAL REVIEW

Audit Firm Tenure

The Cohen Commission (AICPA 2016) mentioned that a new auditor brings a fresh perspective to the audit. Audit tenure is the duration or length of the auditor-client relationship. A rather too long association between the auditor and his client may constitute a threat to independence as personal ties and familiarity may develop between the parties, which may lead to less vigilance on the part of the auditor. Arruñada and Paz-Ares (2016) suggest that the auditor may become less objective and apply less effort toward the detection of material misstatements when firm tenure is longer. Besides that, after several years of being audited by a certain auditor, it could be beneficial for the client to start a relation with a new auditor. Also, Li (2010), suggest that a long term relationship between the auditor and the client imposes a threat to auditor independence for smaller clients weakly monitored by auditors than larger clients.

Raghunandan (2012), on the other hand, found out that audits performed by audit firms with a short term relationship with clients had more audit failures than those performed with audit firms which had long term audit tenures. This theory agrees with Yuniatri 2012, who concluded that when audit tenure was long, quality audit increases.

Investigations on quality audit by Lim and Tan (2010) revealed that quality audit was associated to audit tenure moderated by auditor specialization and audit fees and analyzed this relation using Ordinary Least Square (OLS) regression. In another study by Mc Nichols, (2012), accrual quality model was used to measure quality audit and it was found that companies audited by specialists in their industry had relatively higher quality audit when audit tenure was long. However, this relationship was moderated by auditors' dependence on audit fees from clients.

Sarbanes-Oxley Act commonly known as the SOX Act (2012), found it unlawful for a lead audit partner and reviewer of a registered public auditing firm to conduct audit of client if he has ever been involved in each of the five (5) previous audits of the same client. This Act however falls short of requiring audit firm rotation. It has been thought firms may go ahead and require audit firm rotation especially in cases where there is a change of the lead audit partner. Certainly, long audit tenure has been indicated as a devising factor that may have facilitated the many emerging corporate scandals.

Knapp (1991) shared a similar opinion on the connection between audit tenure and competence with the US audit committee. They agreed that there are high chances that an auditor in the first year of his mandate will detect anomaly and that the ability to detect error decreases gradually, reaching its weakest level after 20 years of engagement hence negating the association of audit tenure with quality.

Agunda (2013) documented evidence from the banking industry on how audit firm tenure affected audit quality. Multiple linear regressions were used with quality audit as the dependent variable and auditor rotation, consultancy services offered and audit fees as the independent variables. A population of 43 commercial banks were used with primary data collected through questionnaires and interview for financial year ended 2013 and analyzed using statistical tools. The study results indicated that by providing audit services on rotational basis, the effect on quality audit will be high compared to long term tenures that go without rotation of either lead audit partners or audit firms.

Mansi et al (2003) documented how audit tenure and cost of debt financing affects audit quality. He divided audit firms into categories of big 6 and non-big 6. They used the information gathered to test whether bond price was included in credit ratings and further examined how the choice of the audit firm affects credit spread. The results found that when evaluating bond ratings, rating agencies considered auditors' characteristics and that non big 6 audit firms were downgraded by one minor rating category. In addition, companies who have maintained long relationship with auditors were rated on their bond and that those with big 6 auditors who were considered to be large received premium on their bond. This implied that the results of audit impact the capital market.

Auditor Reputation

According to De Angelo (2011), users of financial statements use auditor reputation to infer unobserved quality audit based on the provided audit reports. An audit firm builds its reputation over time by producing quality work. To maintain this reputation, total commitment is required from each member of the team since a well-earned reputation should conform to the report produced in each audit report.

Klein and Leffler (2011) formulated a model for endogenous quality to study audit firm reputation versus audit quality. They reported that a firm's reputation or brand was a key characteristic that improved audit quality. High reputation firms produced high quality audit because of higher levels of available resources and greater degree of personnel training and expertise. Similarly, reputation costs provide the incentive to convey higher audit quality. Ultimately "auditors develop a brand name reputation for providing higher quality assurance, with a resulting increase in the quality of audited financial statements" (Li et al. 2013).

Hennes et al (2011) further discussed that firms with a reputation for credible financial reporting are likely to change auditors when quality audit is questioned to avoid capital markets consequences of potentially unreliable financial reporting. Therefore, high reputation firms are more motivated to maintain skilled auditors to maintain the reputation of credible audit quality.

Auditor Independence

According to Sweeney (2014), when an auditor lacks independence then chances of being perceived as not being objective are very high. This occurs if an audit firm becomes too involved with its client and further issues an audit opinion that may deceive and manipulate investors. According to DeFond et al (2012), and in a similar study by Carey and Simnett (2006), they purported that auditors must objectively evaluate the client's performance and withstand client pressure to issue a clean opinion. Hence, independence plays a pivotal role to maintain audit quality. Accountant Jules Muis concluded that such crisis is predictable and avoidable and that the accounting profession had failed in such instances (Kalse & Wester, 2010). To protect the public from abuses, regulators around the world implemented several rules, the Sarbanese-Oxley Act (SOA) being the most familiar one in which SOA issued a restriction of consultancy and advisory services, and another possible solution that could increase independence was mandatory audit firm rotation.

De Angelo (2011) in her study concluded that to enhance independence of the auditor, audit committee should conduct meetings with the external auditor in absence of the company's management and senior committee members. Kimeli (2013) on the other hand, analyzed the factors that determine audit fees a factor that greatly influences the independence of an audit and hence quality audit for firms listed in the NSE. Using a deductive approach he gathered data on firms listed on NSE for a duration of five (5) years, 2012 to 2012. The research objective was tested using correlation analysis and multiple regression analysis. He noted that the big 4s audit firms were the main auditors of these companies.

Auditor Professional Competence and Due Care

Sundgren (2015) argued that certified auditors provided higher level of assurance than non-certified auditors. He noted that non certified auditors are less probable to customize their audit reports compared to their counterparts and that at minimum quality audit differs between the two. This implied that certified auditors provide higher level of assurance than non-certified auditors. An auditor has to maintain professional proficiency through continuing professional education (CPE). Practical work provides a key learning point for an individual.

Manita and Elommal (2010) constructed a new stream of research that focused on auditor professionalism and competence which is driven by an entire audit process as per IAASB (2011). The IAASB describes 'audit quality' (AQ), as the process that concerns such matters as the soundness of the audit methodology, effectiveness of audit tools used, availability of adequate technical support that are all geared towards supporting execution of quality audit.

According to Svanström's (2013) paper, where the author measures quality audit via the management's perception, it purported that managers are in the best position to witness quality audit improvement because they are heavily involved in communicating with auditors and producing annual reports which captures the extent to which reporting quality is raised by the audit process.

Audit Quality

According to Titman and Trueman (2016), auditors need to provide high quality audit services. Palmrose (2011) was also a proponent to the study and described audit report as of quality when there is no misstatement in financial reports. The same view was laid forth by Epstein & Geiger (2014) that the perceived quality audit for audited financial statement is higher since audited financial statement provides absolute assurance to users that the financial statement contains no material errors and misstatement.

Schuer (2012) added that when audit services provided are of higher quality, there is a high possibility that the financial statements are précised and correct reflecting the financial position and results of operations of the entity being audited. Clinch (2010) summarized by stating that the quality of accounting information disclosed includes audit quality. Further, auditing process is performed in conformity to applicable auditing standards. Defond et al (2010) raised the view that audited financial statements provided reasonable assurance that accounting information have been presented in accordance with GAAPs and that are not materially misstated. As suggested by De las Heras (2012), quality audit is related to auditing standards in that an auditor will detect audit failure, will be disciplined and further incentivized to constrain managerial opportunism.

RESEARCH METHODOLOGY

Research Design

The research design used was exploratory research design. Exploratory research design enables give insight about a given subject and relates it to the existing knowledge (Cooper and Schindler, 2013). This is because little is known about firm characteristics on quality audit and thus this study technique enables exploration of the association or relationship between observed quality audit and the explanatory variables. This study aimed to discover the level to which auditors report quality for firms listed in Nairobi Securities Exchange, determine the measures of audit quality, define the explanatory variables and indicate their expected relationship to audit quality.

Target Population

A population refers to an entire group of individuals or objects who share similar characteristics that the researcher intends to use to experiment and draw generalized conclusions. The target population of the study was the 67 listed companies at the Nairobi Securities Exchange (NSE) for a period of five years commencing January 2011 to December 2015. (Source: NSE Website). The target respondents were the board members, heads of finance and senior internal auditors among the firms selected.

Sampling and Sample Size

The study used purposive sampling to select and sample companies with specific characteristics based on researchers judgement from various sectors of the economy listed in the NSE that are plausible for this research and also the respondents who included board members, heads of finance and senior internal auditors from each of the companies. However, the research excluded the 11 banking firms and 6 listed insurance companies due to their operating characteristics, 13 other companies that were listed during the study period, 2 companies that had not prepared consolidated financial statements for the period under review, and due to difference in reporting currencies, 2 companies incorporated outside Kenya were not be analyzed. Therefore, the final sample used in the study was 33 firms that had complete information.

Data Collection Instruments

Data was collected through primary and secondary sources. Primary data was derived from structured questionnaires filled by authorities in the firms who comprise Board of Directors and senior audit committee members and secondary data was derived from certified copies of financial statements and reports, Business magazine and journals, NSE and CMA websites, Central Depository and Settlement Corporations Reports, Company Manuals, Financial Policies and Regulations and entering the results in a data collection schedule. The advantage was that it was convenient for the researcher to administer questionnaires to participants who are accessible to her and can be honest, and the secondary data was readily available therefore fast and easy collection of data as well as suitability to the timeframe and financial resources available. However, the only disadvantage was that this information was historical though for this research it was not necessarily the case as the period under study is between the year 2011 and 2015, the data thus served the intended purpose.

Data Collection Procedure

Semi-structured questionnaires were used to collect primary data through drop and pick later method. According to Kothari (2004) data collection involves the process of getting information regarding the study subject from a given set of respondents. Secondary data was obtained from financial statements of the selected firms. Evaluation of the sampled companies' financial reports for the period under study was done with a focus on the quality audit of the audited financial reports. The variables of concern and their assessment pertaining to quality audit was audit tenure, auditor reputation, auditor independence and auditor professional competence and due care.

Data Analysis and Presentation

The study used both descriptive and inferential statistics to analyze data. This is the process of systematically applying statistical and or logical techniques to describe and evaluate information in a research study. In this research, analysis of data aimed to identify the relationship of quality audit on the joint effect of audit tenure, auditor reputation, auditor independence and auditor professional competence and due care. The study used descriptive statistics such as mean and standard deviation and Inferential statistics such as correlational analysis and regression analysis to calculate and measure accrual quality. OLS regression was used to analyze the data collected to establish the joint effect of all the variables. The data was then measured using a statistical software SPSS and presented in form of narrations and summarized tables. The multiple regression model was as follows:

$$Y = B_o + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + E$$

Where: X_1 - is Audit Tenure; X_2 - is Auditor Reputation; X_3 - is Auditor Independence; X_4 - is Auditor Professional Competence and due care; B_o, - B_1, B_2, B_3, B_4 is the coefficients or constants; E - is the error term

With inclusion of the intervening variable, the model was:

$$Y = B_o + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + B_5X_5 + E$$

Where: B_5X_5 - represents the Intervening Variables

RESEARCH RESULTS

The study sought to establish the effect of audit firm tenure on quality audit for firms listed at the NSE in Kenya. The study found that the duration in years and rotation of auditor or lead partner greatly affect quality of audit for firms listed in the NSE in Kenya. The study also found that rotation of audit firm moderately affected quality audit for firms listed in the NSE in Kenya. This is in agreement with Knapp (1991) who connected audit tenure to competence in which auditors' ability to produce quality work reduced as the tenure was longer. Arunanda and Paz-Ares (2016) also concurred with this theory that the less objective an auditor may become when the tenure is longer, hence reduced quality of an audit report as an effect less effort to detect material misstatements. The Cohen Commission (AICPA 2016) also mentioned that a new auditor brings a fresh perspective to the audit, this further supports the need for mandatory rotation of auditor or lead audit partner.

The study sought to establish the effect of auditor reputation on the quality audit for firms listed in the NSE in Kenya. The study revealed that firms allowed quality audit work to be carried out because of strong commitment and dedication to management role and profession in the organization and that management is motivated to having a thorough audit work done so as to avoid the cost of litigation. The study further found that management does not only consider audit process as part of their professional and social obligations by ensuring that investors and participants in the financial market can rely on audit reports presented to them. This is in agreement with Li et al (2013) and Klein and Leffler (2011) who agreed that high reputation audit firms produced high quality audit because of high levels of available resource tools, personnel, training and expertise as well as the incentive of a brand name reputation for providing higher quality assurance.

The study sought to determine the effect of auditor independence on quality audit for firms listed at the NSE in Kenya. The study found that management ensured that there was no personal relationship with the auditors that would lead to familiarity threats and compromise their independence. The study found that the Internal Auditors independently performed their duties and were always allowed to give objective opinions on their reports and that management always ensured that there was no financial relationship between the audit firms and their committee members that would compromise auditors' independence. The study also found that the auditors at any given time didn't make audit assessments that were more reflective of their professional objective opinion and not their best interest. This is in line with research done by DeFond et al (2012) and Carey and Simnett (2006), who opined that auditors must objectively evaluate clients performance and withstand client pressure to be able to issue quality reports. Also the SOA issues restrictions concerning client and auditor involvement that would decrease auditor independence.

The study sought to determine the effect of auditor professional competence and due care on quality audit for firms listed at the NSE in Kenya. The study found that the auditors have the required academic qualifications to be auditors, that most of the auditors had long working experience in the organization, that there was long office tenure (level of experience) as a full-time professional in their organization and those firms frequently engaged with auditors. The study also revealed that most of the respondents have attended at least two continuing professional education trainings in the last five years and that whether performance in the firms is rated on regular basis, at least bi-annually. This is in agreement with the argument of Sundragen (2015) that certified auditors provided higher level of assurance that non-certified auditors. This was due to being competence and able to comply with the laid IAASB (2011) prescription of quality audit reports.

ANALYSIS OF INFERENTIAL STATISTICS

Pearson correlation coefficient was used to determine the strength and the direction of the relationship between the dependent variable and the independent variable. The analysis using Pearson's product moment correlation was based on the assumption that the data is normally distributed and also because the variables are continuous.

Table 1: Correlation Matrix

		Audit quality	Audit Tenure	Auditor Reputation	Auditor Independence	Auditor Professional Competence	Disciplinary Measures
Audit quality	Pearson Correlation	1					
	Sig. (2-tailed)	.					
Audit Tenure	Pearson Correlation	.646	1				
	Sig. (2-tailed)	.023	.				
Auditor Reputation	Pearson Correlation	.744	.513	1			
	Sig. (2-tailed)	.027	.026	.			
Auditor Independence	Pearson Correlation	.522	.423	.0.327	1		
	Sig. (2-tailed)	.028	.012	.018	.		
Auditor Professional Competence	Pearson Correlation	.734	.533	.520	.431	1	
	Sig. (2-tailed)	.042	.009	.002	.014	.	
Disciplinary Measures	Pearson Correlation	.623	.533	.420	.321	1	1
	Sig. (2-tailed)	.037	.009	.002	.014	.	-

The study computed into single variables per factor by obtaining the averages of audit tenure, auditor reputation, auditor independence, auditor professional competence and due care and disciplinary measures. Pearson's correlations analysis was then conducted at 95% confidence interval and 5% confidence level 2-tailed. The table above indicates the correlation matrix between the factors (audit tenure, auditor reputation, auditor independence, auditor professional competence and due care and disciplinary measures) and audit quality.

As per the table there exists a positive relationship between quality audit and audit tenure as shown by coefficient of 0.646, a positive relationship between quality audit and auditor reputation as expressed by coefficient of 0.744, a positive relationship between quality audit and auditor independence as indicated by coefficient of 0.522, a positive relationship between quality audit and auditor professional competence as illustrated by a coefficient of 0.734 and a positive relationship between quality audit and disciplinary measures as shown by coefficient of magnitude 0.623. This shows that all variables were significant.

The study also showed that there was a strong correlation between the Independent variables and audit quality. Audit Tenure and auditor professional competence and due care gave the highest magnitude of 0.533 while Auditor Reputation and Auditor professional competence and due care gave a slightly lower magnitude of 0.520. This means that audit tenure and auditor professional competence and due care have a higher correlation as compared to auditor professional competence and due care with auditor reputation.

Further, disciplinary measures and audit tenure indicated a high magnitude of 0.533 against all other variables that had lower magnitudes of correlation. This means that when the audit tenure is longer, the more severe disciplinary measures would be taken against an audit firm that does not comply with the laid out regulations and GAAPs as it is assumed that the audit firm is more aware of the impact of their audit report to their client.

Auditor independence on the correlation matrix versus other independent variables scored the least magnitudes. This thus concludes that auditor independence strongly relies on the auditors tenure, auditor reputation and finally the auditors professional competence and due care while exercising their duties.

In addition, the researcher conducted a multiple regression analysis so as to test joint effect of audit tenure, auditor reputation, auditor independence and auditor professional competence and due care on audit quality.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.834	0.696	0.649	2.134

The adjusted R^2 was found to be 0.649 inferring that variations on quality audit which are explained by audit tenure, auditor reputation, auditor independence and auditor professional competence and due care were 64.9%.

Table 3: ANOVA results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	302.34	4	75.585	14.874	.000
	Residual	132.12	27	5.937		
	Total	**434.46**	**30**			

In predicting the effects of Audit Tenure, Auditor Reputation, Auditor Independence and Auditor Professional Competence and due care on audit quality, the regression model test was found to be significant since p-value was less than 0.005 and The calculated F (14.874) was larger than the critical value of F=2.7426.

Table 4: Regression Coefficients

Model	Unstandardized Coefficients		Standardizd Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.904	0.223		4.054	0.000
Audit Tenure	0.864	0.302	0.606	2.861	0.006
Auditor Reputation	0.594	0.116	0.445	5.121	0.000
Auditor Independence	0.716	0.217	0.543	3.300	0.002
Auditor Professional Competence	0.654	0.236	0.531	2.771	0.008

The established model for the study was:

$$Y= 0.904+0.864X_1 + 0.594X_2 + 0.716X_3 + 0.654X_4$$

The results reveal that quality audit will be 0.904 if all other factors are held constant. The study results also show that an increase in audit tenure will lead to a 0.864 increase the quality audit if all other factors are held constant. Again as shown by r=0.594, the study revealed that increase in auditor reputation would lead to an increase in the quality audit if all other factors are held constant. Further the study showed that if there was a unit change in auditor independence, a 0.716 increase in the quality audit would be realized if all other factors are held constant. Also a unit change in auditor professional competence would lead to 0.654 increases in the quality audit if other factors were constant.

Finally the study showed that all variables were significant since p-values were less than 0.005 with audit tenure having the greatest effect and auditor reputation having the least effect on audit quality.

Regression analysis shows how dependent variable is influenced with independent variables.

Table 5: Model Summary for Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.859	0.738	0.686	1.966

Table 6 is a model fit which establish how fit the model equation fits the data. The adjusted R2 was used to establish the predictive power of the study model and it was found to be 0.686 implying that 68.6% of the variations on the quality audit is explained by audit tenure activities, auditor reputation, auditor independence auditor professional competence and due care as well as disciplinary measures leaving 31.4% percent unexplained.

Table 6: ANOVA Results

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	316.34	5	63.268	14.107	0.000
	Residual	112.12	25	4.485		
	Total	448.46	30			

The probability value of 0.000 indicated that the regression relationship was highly significant in predicting how Audit Tenure activities, Auditor reputation, Auditor Independence as well as Auditor Professional Competence and due care affected audit quality. The F calculated at 5 percent level of significance was 14.107 since F calculated is greater than the F critical (value = 2.603), this shows that the overall model was significant.

Table 7: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.731	0.239		3.059	.003
Audit Tenure	0.867	0.305	0.368	2.843	.006
Auditor reputation	0.812	0.287	0.386	2.829	.006
Auditor Independence	0.732	0.129	0.832	5.674	.000
Auditor Professional Competence	0.712	0.222	0.462	3.207	.002
Disciplinary measures	0.673	0.278	0.581	2.421	.023

The established model for the study was:

$$Y = 0.731 + 0.867\ X_1 + 0.812\ X_2 + 0.732X_3 + 0.712\ X_4 + 0.673\ X_5$$

The regression equation above has established that taking all factors into account (audit tenure activities, auditor reputation, auditor independence auditor professional competence and due care and disciplinary measures) constant at zero, the quality audit was 0.731. The findings presented also show that taking all other independent variables at zero, a unit increase in audit tenure activities would lead to a 0.867 increases on the audit quality. The variable was significant since 0.006<0.05.

The study also found that a unit increase in auditor reputation would lead to a 0.812 increase on audit quality. The variable was significant since 0.006<0.05. Further the study found that a unit increase in the scores of auditor independence would lead to a 0.732 increase on the audit quality. The variable was significant since 0.000<0.05.

Further, the findings shows that a unit increases in the auditor professional competence and due care would lead to a 0.712 increase on audit quality. The variable was significant since 0.002<0.05. The study further found that increase in disciplinary measures would lead to a 0.673 increase in the quality audit if all the variables are held constant.

Overall, audit tenure activities had the greatest effect on the influence of stakeholder activities on audit quality, followed by auditor reputation, then auditor independence then auditor professional competence and due care while disciplinary measures had the least effect on audit quality. All the variables were significant (p<0.05).

Generally the study indicates a positive and significant influence of independent variables on the dependent variable. Audit firm tenure, auditor reputation, auditor independence and auditor professional competence and due care positively affected quality of audit among the listed firms in the NSE in Kenya. 68.6% of all changes in audit quality among the firms selected was due to the independent variables while other factors not included in the study influenced the remaining percentage.

CONCLUSIONS

The study also concluded that audit firm tenure positively affect quality audit for firms listed in the NSE in Kenya. The study found that that duration in years and rotation of auditor or lead partner greatly affect quality audit for firms listed in the NSE in Kenya. If the tenure of the audit firm or lead audit partner was too long, quality audit would decrease and vice versa.

The study concluded that auditor reputation affects quality audit for firms listed in the NSE in Kenya positively. Firms were found to allow quality audit work to be carried out because of strong commitment and dedication to management role and profession in the organization and management is motivated to having a thorough audit work done so as to avoid the costs relating to litigation.

The study concluded that auditor independence has a significant effect on quality audit for firms listed in the NSE in Kenya. This is contributed by the fact that management ensure that there was no personal relationship with the auditors that would lead to familiarity threats and compromise their independence and that the Internal Auditors independently performed their duties and were always allowed to give objective opinions on their reports

The study concluded that auditor professional competence and due care has a positive and significant effect on quality audit for firms listed in the NSE in Kenya. The auditors were found to have the required academic qualifications to be auditors and there was long office tenure (level of experience) as a full-time professional in their organization and those firms frequently engaged with auditors. The study also revealed that most of the respondents have attended at least two continuing professional education trainings in the last five years which aid improve audit quality.

RECOMMENDATIONS

The results suggest that it is important to consider the effect of detection mechanisms such as auditor quality while examining the relation between executive compensation and accounting manipulation. There is thus the need for the listed companies to adopt corporate governance practices that are effective to address key auditing practices for purposes of audit quality.

The study recommended that it is therefore utmost necessary for firms to re-elect members of the audit committee who have served for more than 9 years in the board because of their vast experience. Also, the presence of a robust audit committee will reduce financial misreporting and enhance quality monitoring. As such, experienced audit committee members should be a key factor for firms.

The study recommended that there is need to increase the proportion of independent auditors since an increase in their number reduces the chances of financial misreporting and leads to positive perception by investors. In so doing, there is improved firm performance. Moreover, in order to reduce financial distress in a company there is also need to increase the number of independent directors because they are independent and without influence from the directors.

The study also recommends that there should be high level of professionalism by the audit firms. This means that companies that are highly indebted and auditors fail to prove such indebtness should be fined or operating license be withdrawn so as to safeguard the shareholders of the companies. In addition the officials of the company who engage in misstatements of the financial statements should be sacked and charged in the court of law.

The study recommends that measures should be put in place by relevant authorities like ICPAK for disclosure of pertinent issues such as audit fees to encourage availability of such data which are important variables in such a study. It was also noted that some listed companies failed to publish their audited accounts as per requirement by the CMA Act making available information limited. Consequently, disciplinary actions should be taken upon such companies for failure to comply with GAAPs and IAASB.

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