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INTERNAL FACTORS INFLUENCING EXTERNAL AUDITORS INDEPENDENCE AMONG PRACTICING ACCOUNTANTS IN KENYA

By Harrison Mbinj Omondi[1] and Duncan Elly Ochieng (PhD, CIFA)[2]

Abstract

Purpose – Auditors independence holds sway in ensuring that the public has confidence in financial reporting. Therefore, this study focus was to examine the factors that determine external auditors' independence in Kenya.

Methodology - The study employed a cross-sectional descriptive study design and used primary data. The collected data was analyzed with the help of the SPSS software version 22 and presented with the help of frequency distributions, computation of mean and standard deviation. The association between the research variables was presented using an ordinal a regression model.

Findings – The study established that internal factors influence auditor independence by 31.7%. From the results of the research, it also revealed that there is a significant relationship between audit tenure, audit firm size and audit independence. This was indicated with a p-value of 0.029 and 0.009. The study also established that there is no significant relationship between audit committee and audit independence with a p-value of 0.465. The study concludes that audit tenure and firm size affect audit independence and thereby the study recommends the need for ICPAK to develop a policy that will guide audit tenure and audit committee.

Implications –The study findings suggest that ICPAK develops a policy that will guide the audit tenure and audit committees, this will in essence promote an understanding of the auditors' independence in the profession. The study also further suggested that similar studies should be carried and focus on the perception of users such as institutional and private investors, audit committees and members of regulatory bodies.

Value -The findings of the study concludes that audit tenure and firm size affect audit independence and thereby the study recommends the need for the Institute of Certified Public Accountants of Kenya (ICPAK) to develop a policy that will guide audit tenure and audit committee.

Key words: Audit Committee, Auditor Independence, Auditor, Audit tenure, Audit Quality.

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Introduction

Companies are perceived as the nexus of contractual relationships between different interested groups (Jensen & Meckling, 1976). The most important among these agency relationships are between managers (agents) and shareholders (principals), and creditors (principals) and shareholders (agents). In these relationships, the agents are expected to act in the best interests of the principals.

Experience shows that various mechanisms must be put in place to ensure that agents protect the interests of the other parties involved. One such mechanism is the audited financial statement (Arnold & De Lange, 2004; Chow, 1982; Jensen & Meckling, 1976; Ross, 1973; Watts & Zimmerman, 1986). According to studies conducted by Al-Ajmi and Saudagaran (2011), corporate failure and corporate problems with financial reporting have spawned additional reasons for the continuous debate by regulators, legislators, financial-statement users, and researchers about the importance and role of auditors in mitigating the agency problem. Performing this crucial role depends largely, among other things, on the audit quality. The model of audit quality describes audit quality as the combination of two probabilities: that of detecting a misstatement (i.e. competence) and that of reporting it, that is, independence (Al-Ajmi & Saudagaran, 2011).

The Agency Theory proposes that due to information asymmetries and self-interest, principals have no reasons to trust their agents. They will seek to resolve their concerns by putting in place mechanisms to align the interests of agents with principals to reduce the scope for information asymmetries and opportunistic behaviour (ICAEW, 2005). The Council of the Institute of Certified Public Accountants of Kenya (ICPAK) established by the Accountants Act (UNACTAD, 2006) regulates audit practice in Kenya. This Act stipulates that companies can only appoint auditors registered by the Institute. These auditors must meet the criteria for an auditor as laid out in the Act and requires that auditors' report should be annexed to the profit and loss account and balance sheet and prescribes the contents of the auditors' report (Ibid).

Auditor Independence

Audit independence is the ability of the external auditor to perform his/her audit duties with integrity and impartiality (Akpom & Dimkpah, 2013). They further note, "public opinions about audit independence are based more on their perception of auditor independence than on actual independence" (Ibid). Audit independence is the primary justification for the existence, and thus the hallmark of the auditing profession. Independence is recognized as the primary attribute to be maintained by auditors in all circumstances (Abu Bakar & Ahmad, 2009).

Auditor independence is a function of the existence of a dispute between the auditor and the client with regards to the treatment of audit reporting issues or issues of fraud and financial misstatements (Adelopo, 2016; Beattie, Fearnley, & Brandt, 2001). It is hard to understand and conceptualize auditor independence since there is no formal theory of auditor independence (Ibid). Adelopo (2016), notes that researchers and academicians are faced with ambiguity in the conceptualization and framing of ideas concerning what constitutes auditor independence. He argues that this create room for manipulation which leads to the creation of further ambiguities.

Auditor independence according to O'Regan (2004) is "the absence of a relationship, obligation, or conflict of interest that could compromise an auditor's judgment." He notes that independence can also be conceptualized regarding a state of mind, involving personal character, ethics, and honesty". It is the "ability to withstand pressure from management influence when conducting an audit or providing audit-related services so that the professional integrity of the auditor is not compromised" (Gay & Simnett, 2000). For an auditor to be independent, it is essential that the individual be independent in both fact and appearance.

In 2002, the failure of the public accounting firm Arthur Andersen increased scrutiny over the practices of public auditors (Eisenberg & Macey, 2004). The Andersen failure also resulted in questions about overall audits and audit quality placing stress on the audit profession (Gendron, Suddaby, & Lam, 2006). Gendron, Suddaby, and Qu (2009) observed that this incident, in combination with various other failures in the accounting industry, caused concern about the ethical values of professional accountants. Fearnley, Beattie, and Brandt (2005) further emphasized that these failures contribute to a loss of confidence in the ethical values within audit firms, which was directly linked to skepticism over the independence of audit firms and their accounting professionals. As such, among ethical values and standards in the accounting profession, one that is frequently discussed and researched is auditor independence.

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The inability of auditors to maintain professional distance has led to the loss of jobs with the failure of audit firm Arthur Andersen and increased concern over the quality of auditing in the case of the failure of Chinese audit firm Zhong Tian (Du & Stevens, 2013). Compromised auditor independence has also contributed to losses in investor confidence with audit failures and subsequent faltering of large corporations such as Enron, WorldCom, and Tyco (York-Wyatt & Leavell). Auditor independence allows an auditor to exercise due diligence without biases for or against the client. Its importance to a quality audit is paramount, and as Fearnley et al. (2005) explained, the independent audit of a company's financial statements is essential to the company's successful operation in capital markets.

Regulations over the accounting profession call for quality audits that are reliable and useful for the users of financial statements. As Fearnley et al. (2005) indicated, material changes to financial statements, along with corporate failures, further lead to doubting audit quality and doubting the ethical values of auditors. Thus, the authors suggested the need for more skepticism over the value of the opinion offered to be certain of the reliability of the audited financial statements. To improve audit quality and auditor conduct globally, the International Federation of Accountants (IFAC) promoted global harmonization of accounting standards in the areas of practice, accounting education, professional codes of conduct, management accounting, and public-sector accounting (Farrell & Cobbin, 2001). About professional ethics, over 150 national accounting organisations have adopted the Code of Ethics for Professional Accountants (COE) released by the International Ethics Standards Board for Accountants (IESBA, 2013). The IESBA is the organisational body that develops standards and pronouncements for professional accountants across the world as the professional conduct standard-setting board of the IFAC.

As Clements, Neill, and Stovall (2009) observed, adoption of IESBA COE varies, and some organisations have decided to retain their codes of ethics if they meet the stringency requirements of the IESBA. As (Clements et al., 2009) explained, membership in the IFAC is not contingent upon adoption of the IESBA COE. However, members and member bodies may not apply standards of conduct that are less stringent than those issued by IESBA are.

While monitoring of ethical compliance seems to be on the rise, professional accountants still have significant discretion in the interpretation of ethical codes of conduct (Flanagan & Clarke,

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2007). Thus, research on the consistency of perception of, and compliance with, professional standards is increasingly more widespread as both practical and ethical standards converge at an international level. As Fraser (2010) posited, a global business environment has led to a complex ethical and convenient accounting environment, where it is hard for international auditing regulations to meet the needs of members of the commercial markets.

Cases of inadequate and outright auditor negligence and non-independence in Kenya have been noted by the BFID (2011) which noted for instance that in the fourth quarter of 2011, a total of Kshs 137 Million was defrauded from Kenyan banks out of which Kshs 50 Million was through insider dealings. Several studies that have been carried out in Kenya indicate that internal audit departments' effectiveness ranges from ineffective to averagely effective. These studies further highlight that auditor's independence is below average in most cases (Ongeri, Okioga, & Okwena, 2013; Rono, 2006).

Economic Factors

Moore, Tetlock, Tanlu, and Bazerman (2006) Argue that the "moral-seduction theory" predict that auditor decisions are affected by economic and social pressures in ways that affect audit quality. Arruñada (2013) opines that when there is a disparity between the auditor and client on the inclusion or otherwise of a particular matter in an audit report (leading either to a qualified report or the impossibility of expressing an opinion) and the client threatens to disengage the auditor, the latter may 'accede' to the demands of the former in order to retain the contract. He further notes that this economically motivated accession compromises the independence of the auditor. In such a scenario auditor independence is undermined by monetary values assigned to the services offered by the auditor.

Abu Bakar and Ahmad (2009) posit that the Malaysian Institute of Accountants by-law (Section B-1.98 on Professional Independence) requires that "if the total fees (arising from assurance and non-assurance services) generated by one assurance client or its related entities exceed 15% of the firm's total fees in each year over two consecutive financial periods, financial dependency shall be considered to exist, in which case, a self-interest threat to independence is created. In such event, the only course of action is to refuse to perform or withdraw from the assurance engagement".

Regulatory Factors

The accounting and regulatory professions are both under regulations. These regulations may affect the independence of auditors. Lack of agreement of all auditors on a particular accounting treatment due to the flexibility of accounting standards is a threat to auditor independence (Knapp, 1985; Magee & Tseng, 1990). Among the regulatory factors that influence auditor independence include: the existence of unlimited legal liability for auditors (Farmer, Rittenberg, & Trompeter, 1987); strong enforcement of standards; effective discipline of corporations and auditors; control over the appointment of auditors (ICAS 1993; APB, 1994); and the existence of an audit committee (Cadbury, 1992).

According to an Institute of Directors in Southern Africa Report (2013), "public sector entities operate within a unique regulatory framework with some pieces of legislation and regulations that need to be complied with. The terms of reference of a public-sector audit committee do not always clearly define the requirements of the audit committee about the entity's environment."

Firm Characteristics

Several empirical studies have attempted to establish the relationship between audit firm size and Auditor Independence. These studies have found out that there is a positive correlation between the two (Alvin Alleyne, Devonish, & Alleyne, 2006; Bakar, Rahman, & Rashid, 2005; DeAngelo, 1981; Gul, 1989; McKinley, Pany, & Reckers, 1985; Nichols & Smith, 1983; Shockley, 1981; Shockley & Holt, 1983). To say the least, scholars and practitioners have argued that "certain characteristics inherent in small audit practices may increase the danger of impairment of independence, for example, the tendency toward a more personalized mode of service and close relationship with the client" (Shockley, 1981). According to him, large firms are likely to operate more independently as compared to small firms. The size of large firms inspires them to provide quality and independent audits to protect their reputations (Ibid).

Challenges Faced in Establishing Auditor Independence

In a report prepared by Ernst & Young (2013) for the Audit Committee Leadership Summit, "some of the dynamics that elevate the importance of internal audit are the same dynamics that subject auditors to significant challenges. The report indicates that at large companies, these

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challenges include a global operating environment coupled with an intensified focus on risk (Ibid). The global operating environment poses the challenge of resourcing and multiple regulatory regimes; while an intensified focus on risk presents information technology risks and compliance risks.

Accountability, role clarity, and reporting lines are not always clear in the public sector (concerning the shareholder, the 'directors' and management as applicable in the private sector). The manner in which some public-sector entities are structured makes this a specific challenge (Institute of Directors in Southern Africa Report, 2013). The independence of the audit committee may be impaired due to previous/current relationships of audit committee members or the audit committee as a whole and political standing, among other factors.

Research Problem

Auditor's independence can be viewed through actual or perceived independence with actual independence referring to the mental attitude of the auditor regarding professional objectivity while perceived independence relates to the public's or others‟ perceptions of the auditor's independence (Gul & Tsui, 1992). Auditor's independence has gained prominence in the accounting profession with some corporate scandals. The recent bankruptcies of many large corporations with clean auditor's reports around the globe have called to question the validity of the financial statements prepared by those corporations. The case of Enron in the United States, Parmalat in Italy and Cadbury in Nigeria are clear examples (Oladele, 2012). In Kenya, the recent corporate accounting scandal in Mumias has also cast doubt on the quality of reported earnings and the ability of audit process to effectively constrain earnings management of companies across the world and Kenya in particular (PAC, 2015; Enofe, 2010). The aforementioned corporate financial failures have cast aspersions on the quality of audit process carried out by audit firms.

According to Okolie (2007), statutory auditors are expected to audit the financial statements prepared by the directors of enterprises and express an independent opinion on them‖. Therefore, in accounting practice of today, the independence of the auditor is one of the most important issues because it increases the effectiveness of the audit by ensuring that the auditor plans and carries out the audit objectively. Several regulatory bodies have recently established new independence standards, since the general setting, within which external auditor independence perceptions are

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formed, is subject to continuous change (IFAC, 2001; ICAEW, 2001). Also, the seventh schedule of the Company's Act (CAP 486) laws of Kenya requires the auditor to express in their reports whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for their audit. Their regulatory frameworks have provided the basis for auditor independence, albeit at a low success level.

Prior studies have examined factors affecting auditor independence such as: external and internal factors Rusmanto (2001) and Oladele, 2012), Non-Audit Services as factor affecting audit independence; the size of audit firm (Bakar et al., 2005) the clients' size (Pany & Reckers, 1980) factors that influence internal audit independence in Kenya and the competition in audit services market (Gul, 1991). Though studies exist on audit independence, literature review indicates that most studies have focused on both internal and external factors with limited studies focusing solely on internal factors influencing auditor independence. Due to paucity of research, this study was conducted to establish the internal determinants of external auditor's independence in Kenya.

Objective of the Study

The main objective of the research was to determine the internal factors influencing external auditors' independence among practicing accountants in Kenya.

The specific objectives of the study were as follows:

i. To determine the influence of firm size on external auditors' independence in Kenya.
ii. To determine the effect of audit committee on external auditors' independence in Kenya.
iii. To determine the effect of auditor's tenure on external auditors' independence in Kenya.

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Hypothesis

In order to attain the objectives of this study, this research tested the following null hypotheses:

H01: Firm size has no significant influence on external auditor's independence in Kenya

H02: Audit committee has no significant effect on external auditor's independence in Kenya.

H03: Auditor's tenure has no significant effect on external auditor's independence in Kenya.

Methodology

Research design

The study used a cross-sectional descriptive study design. Descriptive studies describe characteristics associated with the subject population. Saunders et al., (2003) assert that a descriptive research portrays an accurate profile of persons, events or situations. Kimani (2006) notes that a descriptive research collects data from members of a population and helps the researcher get the descriptive phenomena by asking individuals about their perceptions, attitudes, behaviour or values. The cross-sectional descriptive survey was also used to allow for the collection of data from many respondents over a small period thus limiting the cost.

Population

For the purposes of the study, the research concentrated on audit firms listed by ICPAK and with operations in Nairobi in the year 2015. The study was limited to audit firms within Nairobi County. The study used stratified sampling to determine the number of audit firms to be selected as a sample size in the following categories of small, medium and large. This helped in categorising the audit firms according to the size of the firm. The proportion of small, medium and big audit firms was sourced from ICPAK (ICPAK, 2014). After determining the sample size for each category of the audit firms, purposive sampling was used to select Key respondents who participated in the study from different audit firms.

Data Collection

Data collection is the gathering of empirical evidence to gain new insights about a situation and answer questions that prompt undertaking of the research (Flick, 2009). Primary data was collected from the key staff, managers and directors of audit firms in Nairobi using a semi-structured questionnaire that was developed by the researcher by research questions.

Data Analysis

The findings of the study were tested for reliability and accuracy to ensure there is uniformity, consistency and the completeness as well as arranging the data to easy the process of coding and tabulation before it is analyzed. Once the testing of the data was done then entered into the statistical package for social sciences (SPSS) statistics for analysis version 22. The statistics was then analyzed by generating descriptive statistics such as percentage and measures of central tendency like mean and standard deviations. To compute the regression analysis of the variables that were measured. The research was further analyzed using a multivariate linear regression, coefficients of determination (R squared), ANOVA, and beta coefficients for the model to state how much the model was explained any changes in the dependent variable that is the auditor's independence. The regression model was used to compute the association among the firms' specific internal firm factors and auditors' independence.

The study used the following regression model to conceptualize if the selected internal factors influenced the independence of external auditors in Kenya, since the study has more than two independent variables.

$\mathbf{Y = \beta 0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon}$ Where Y: Auditors' independence, βo: Constant, X_1: Firm factor; X_2: Audit tenure, X_3: Audit committee,

B (0, 1,2,3) are the beta coefficients for the respective independent variables

ε is the error term in the model

Results and Discussions

The purpose of this study was to analyse the audit firm's internal factors such as audit tenure, audit firm size and composition and diversity of audit committee influence on auditors' independence among registered and practising accountants in Kenya. It further examined the extent to which such factors affect the independence of auditors. This chapter, therefore, presents the results of the study and the inferences made from the analysis.

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The Descriptive Characteristics of the Respondents

Before the results of the questionnaire survey are reported, it is important that the background information of respondents in this study be presented. The respondents were asked about their gender, age, experience and academic qualification. This information is important since it provides an overall impression of the respondents in the study and thereby allowing for investigation of the main demographic factors if possible in the study.

The study collected data from 97 auditors. Among them, 71% were male and 29% female (*Figure 1*). These findings show that the field of auditing is still dominated by the males as also reported by Wekesa (2014).

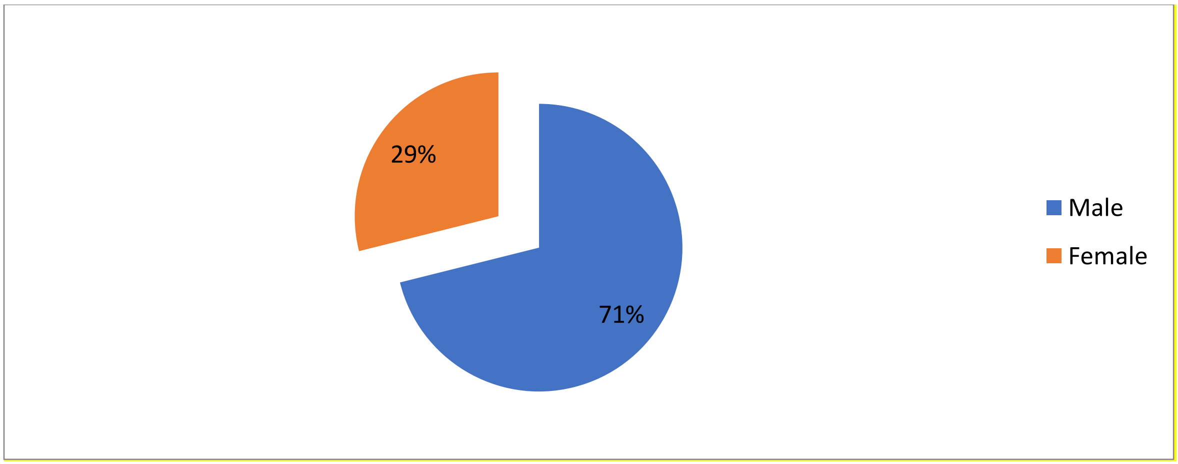

Figure 1: Distribution of Respondents by Gender

Source: Author 2016

The majority of the respondents (85%) were aged between 18 and 33 years, which comprised of the youth. Forty-five per cent were aged between 18 and 27 years, while 39% were aged between 28 and 33 years, 9% between 34 and 39 years, 4% and 2% between 40-49 years and more than 50 years respectively (*Table 1*). This indicated that respondents in the study were heterogeneous.

Table 1: Distribution of Respondents by Age

Age	Frequency	Percentage
18-27 years	44	45.4
28-33 years	38	39.2

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34-39 years	9	9.3
40-49 years	4	4.1
50 and above	2	2.1
Total	**97**	**100**

Source: Author 2016

Concerning the level of education of the respondents, most of them had first degree and above with 80% possessing a Bachelors' degree, and 19% of them had a Master's degree. Only 1% of the respondents had diploma level of education *(Figure 2*). These Findings indicate that the respondents esteem the importance of higher education in the career as such majority had at least degree level of education. These results are similar to the results of Wekesa (2014).

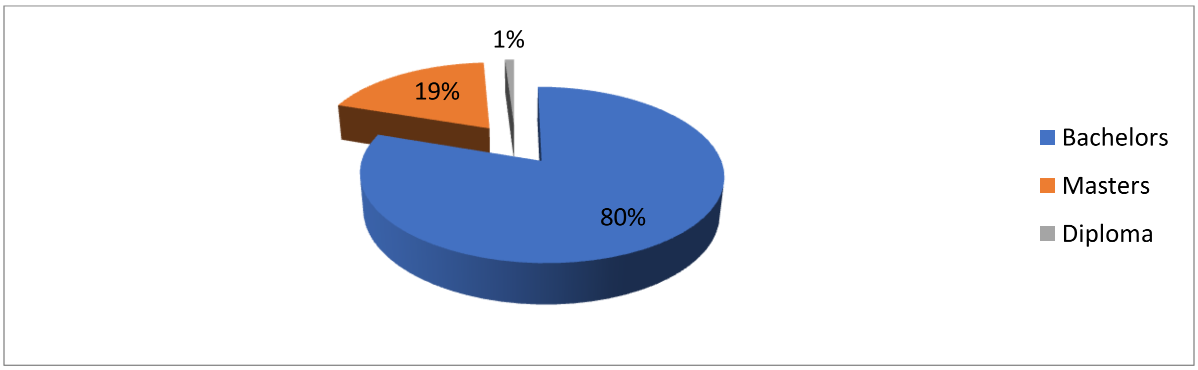

Figure 2: Level of Education of Respondents

Source: Author 2016

Most of the respondents (82%) had a working experience of at least one year in the audit firm they worked in, whereby 34% had been working for between 3-5 years in the audit company and another 25% between 1 and 3 years, 17% had been working for between 5 and 10 years and 7% for more than 10 years. Only 18% had been working in their respective audit firms for less than one year (*Figure 3*). The study indicates that majority of the respondents had considerable experience in the audit industry as such could be acquainted with some of the challenges facing auditor independence. These findings are contrary to the study by Ahmad (2012) who had the majority of the respondents with work experience of above five years. This was attributed to the reason that the study targeted managers as the main respondents.

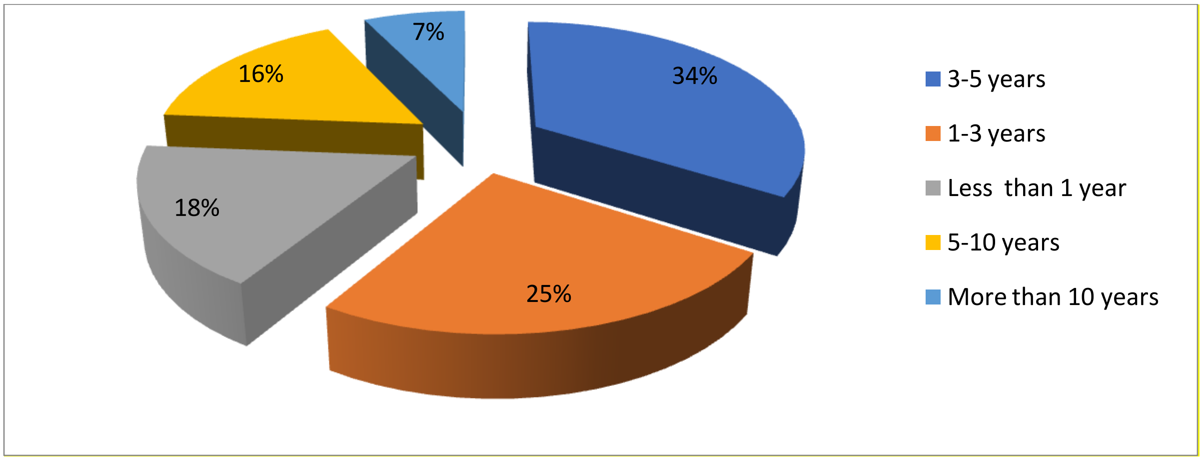

Figure 3: Distribution of respondents based on the years of experience

Source: Author 2016

The study also sought to understand the sizes of firms depending on the number of their employees. The majority of the firms (62.5%) had more than 100 employees while 27% had less than 50 employees and 10% had between 50 and 100 employees (*Table 2*). From the findings, it can be deduced that majority of auditors work in big firms, and this may be attributed to the dominance of big firms in the audit industry.

Table 2: Size of the Firm

Number of employees	Frequency	Percentage
More than 100 employees	60	62.5
Less than 50 employees	26	27.1
50-100 employees	10	10.4
Total	**96**	**100**

Source: Author 2016

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The researcher sought to establish whether the respondents possessed professional certificates such as ACCA and CPA. Most of the respondents (81%) were in possession while 19% did not possess. Among those who possessed the professional certificates, 51% had fully registered as members of professional bodies such as ICPAK while 49% were associates or had partially registered as members. Very few of the respondents indicated that they had no professional certificates on accounting qualification such as the ACCA or CPA. This is not surprising given that accounting qualification is a requirement for one to work as an auditor. From the findings of the study, it was established that majority of the respondents perceive that being a member of ICPAK is beneficial to them. Hence the results indicate that majority of the respondents were full members of ICPAK, an institute for certified public accountants in Kenya.

Table 3: Membership to Professional bodies

Variable		Frequency	Percentage
ACCA or CPA certificate	Yes	79	81.4
	No	18	18.6
	Total	**97**	**100**
Membership	Full Membership	41	51.3
	Associate	39	48.8
	Total	**80**	**100**

Source: Author 2016

The study further sought to establish the auditor's level of independence through a five-point Likert scale (where 1 is very high and 5 very low). The respondents felt that the auditors held a high degree of independence (mean=2.61). Half of the respondents (50%) cited that the level of independence was average, while 28% believed it was high and 11% each believed it was very high and low respectively. The perception of the respondents towards auditor independence was that AI level is moderate. This finding only confirms that there are possible factors that affect AI in Kenya. These results are supported by the results of Bichanga and Kamau (2012) who established that most auditors are members of professional bodies.

Table 4: Auditors' level of independence

Auditors level of independence	Frequency	Percentage	Mean
Average	48	49.5	2.61

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High	27	27.8
Very high	11	11.3
Low	11	11.3
Total	**97**	**100**

Source: Author 2016

Factors that Influence Auditors' Independence

The aim of this study was to analyse the factors that affect auditors' independence among registered and practising accountants in Kenya. This section, therefore, presents the detailed findings of the study. The findings are based on respondents' perceptions and regression analysis.

Audit Tenure and Auditors Independence

The study sought to establish the various factors that contribute to the independence of the auditors.

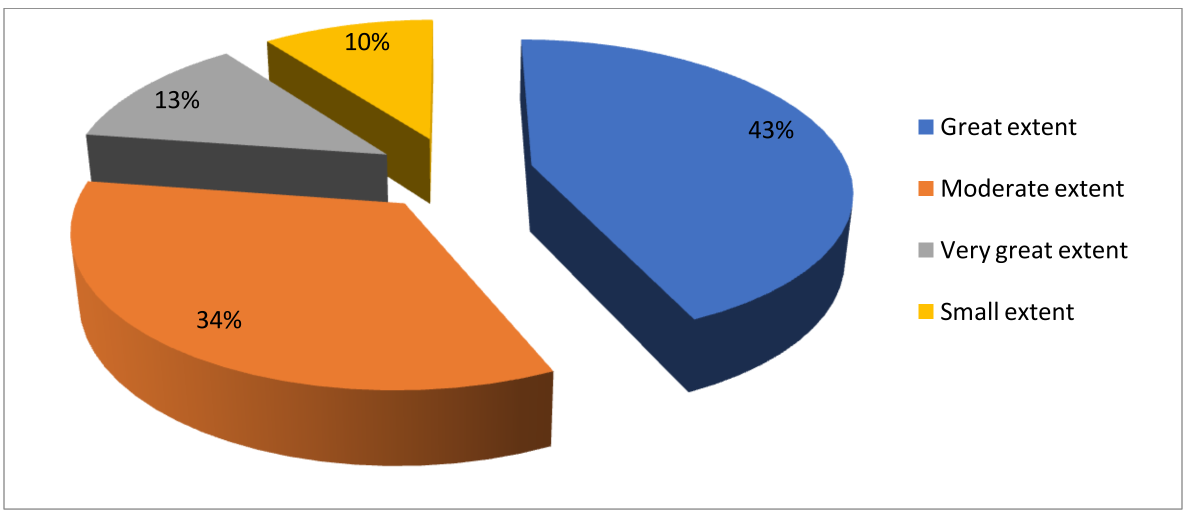

Figure 4: Audit firm size and auditors' independence

Source: Author 2016

To understand the relationship between audit tenure and audit independence, various Likert questions were asked. From the responses, it emerged that 43% of the respondents believed that audit tenure affects audit independence to a great extent, 34% of the respondents believed to a moderate extent, 13% believed to a very great extent and 10% to a small extent. It can thus be established that there is a perception that audit tenure as a factor determines auditor independ-

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ence. This according to Alvin Alleyne et al. (2006) is because tenure impacts on the relationship between clients and auditors with the resulting impact being on the quality of information shared.

An in-depth look at the extent of the influence of audit tenure to the auditors' independence revealed that audit tenure influenced the auditors' independence to a great extent as shown in Table 8 below (mean=2). The respondents perceived that large audit firms were able to resist pressures from clients to a very great extent (mean=1.71). Again, they perceived that prolonged auditors' tenure was bound to impair the independence of the auditors to a great extent (mean=2.26) and an audit tenure of more than 10 years could cause the auditors to lose their scepticisms to a great extent (mean=2.36). Further small tenure was also believed to cause some audit independence problems to a great extent (mean=2.44). From the Likert responses, it can be deduced that the respondents believed that both short-term tenure and long-term tenure could affect the independence of auditors. This could be attributed to the reason that complacency in audit or conformity to audit procedures can be carried out by audit firms with both short and long-term tenure. A possible explanation to this is audit fees that act as moderating factor to both long term and short-term tenure thus affecting audit independence of firms. These findings are supported by the results of Oladele (2012) in a study carried out in Nigeria.

Table 5: Extent of the influence of audit tenure on the auditors' independence

Descriptive Statistics	N	Mean	Variance
Large audit firms are often considered to be more able to resist pressures from client's management.	97	1.71	0.721
Prolonged auditors' tenure impairs the independence of the auditors.	97	2.26	1.083
Auditors tend to lose their professional scepticism if the audit tenure is more than 10 years.	97	2.36	1.165
Audit firms with small tenure are also likely to face audit independence problems.	97	2.44	1.145

Source: Author 2016

Audit firm size

Audit firm size was also seen to influence the independence of the auditors in that 40% of the respondents believed it influenced to a great extent, 29% to a moderate extent, 16% to a very great extent and 11% to a small extent. However, 4% felt that audit firm size had no influence

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on the auditors' independence. From the results of the study, it is worth noting that there was no clear majority as to whether the size of the audit firm impacts audit independence. This could be attributed to respondents coming from both small and big audit firms, with the respondents believing that both faces the challenge of audit independence. This is supported by the findings of Naslmosavi, Sofian, and Saat (2013) who asserted that audit firm size might not affect audit independence for audit firm faces same challenges, big or small.

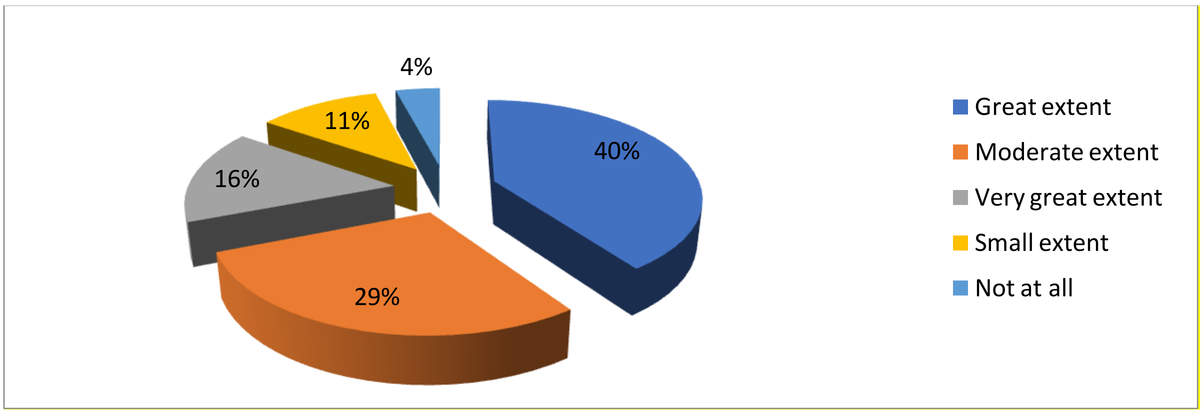

Figure 5: Audit firm size and auditors' independence

Source: Author 2016

The audit firm size was found to be another factor influencing the auditors' independence. According to the results of Table 6, the respondents perceived that most of the audit firm size factors exerted a significant impact on the independence of the auditors (mean =2, great extent).

Table 6: Audit firm size and auditors' independence

Descriptive Statistics	N	Mean	Std. Deviation

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Large firms can have higher professional ethics hence better audit independence	97	1.7	0.974
Large firm, with more trained personnel, has a higher audit independence	97	1.7	0.856
The larger the audit firm, the higher the audit independence	97	2.2	1.152
Audit firm size is not a major factor influencing audit independence	97	2.9	1.31
Small accounting practitioners also issue independent audit reports	97	2.2	1.01

Source: Author 2016

Large firms were perceived to have higher professional ethics hence not interfere with the independence of the auditors (mean=1.7). The reason that could explain this is that large audit firms may have more resources at their disposal to train their employees on professional ethics. It was also presumed that large firms have more trained personnel translating to higher audit independence (mean=1.7). The respondents also agreed to a great extent that the larger the audit firm higher the audit independence. This could be attributed to the reason that it is believed that big audit firms tend to have depersonalised services that may allow more independence that small audit firms that have personalised services with their clients. A question was also posed to respondents whether the firm size mattered with regards to auditors' independence. It was established that audit firm size was a factor to a moderate extent (mean=3).

4.3.3 Audit Committee and Auditor's Independence

The study sought to find out the perceived effect of audit committee on auditor independence. The study established that majority of the respondents 45% of the respondents agreed to a greater extent that audit committee affect audit independence. Muhamad Sori and Mohamad (2009), argues, is linked to the perception that audit committee composition is linked to supporting the management or the shareholders, and this may affect the auditors while carrying out their day-to-day audit work.

Further, the study sought to establish the auditors' perception on the effects of audit committee on the independence of the auditors. The results revealed that auditors perceived that audit committees wielded a significant influence on the independence of the auditors (mean=2). The most significant factors (lowest mean) were the expertise of the audit committee enhance auditor in-

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dependence; audit committee meetings lead to independence and reporting of the committee improve auditors' independence. The responses shown by the majority of the respondents might be a sign of agreement with the general perceptions that composition of audit committee and active audit committee that spend more time through having frequent meetings to discuss issues of internal control, risk, corporate reporting and any matters arising from business operations would enhance auditor independence.

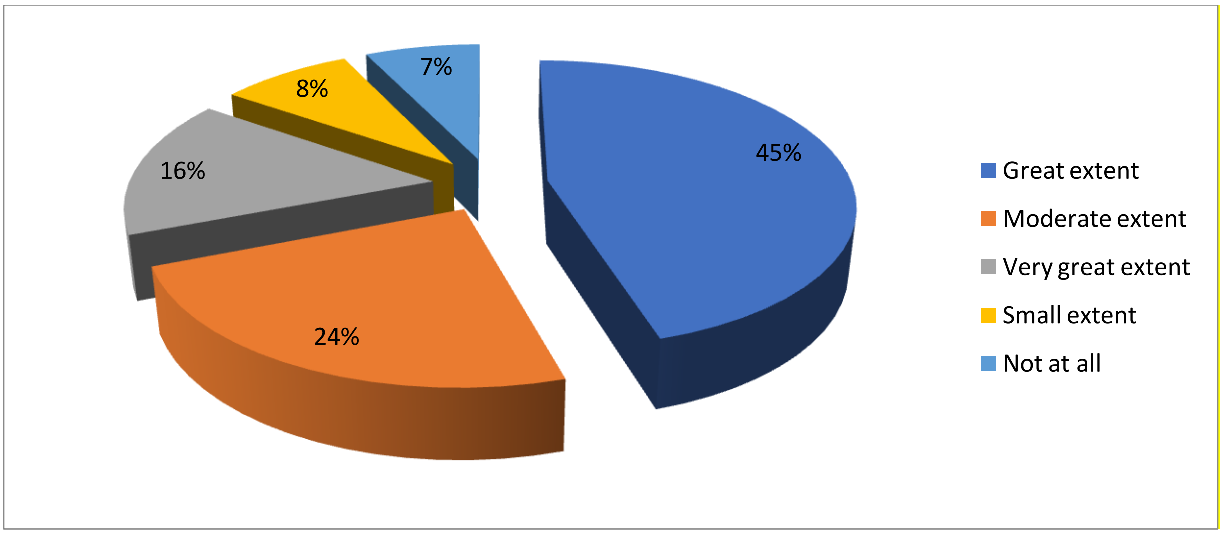

Figure 6: Audit Committee and auditors' independence

Source: Author 2016

Table 7: Extent of audit committee influence on the auditors' independence

Descriptive Statistics	N	Mean	Variance
Audit Committee Meetings leads to auditor independence	97	2.09	1.137
The expertise of audit committee members enhances auditor independence	97	1.84	0.954
The size of the audit committee plays a role in improving auditor independence	97	2.37	1.158
Audit committee reports improves auditor's independence	97	2.12	1.043

Source: Author 2016

Other factors

Apart from the above factors, auditors identified other factors that could be affecting their independence while performing their daily duties. The factors ranged from the audit fees charged as

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cited by 15% of the respondents, other non-audit services the auditors are required to perform aside from auditing (10%), audit staff remuneration (8%), inappropriate client relationships (8%), the experience of auditors in terms of length of service (8%), unhealthy competition in the auditing industry (7%) and bribery cases where auditors receive gifts and bribes from clients in order to give a report that favours the clients (Figure 3). Other factors mentioned were management's influence, inadequate training of auditors, fear of peer reviews procedures and political influence among others.

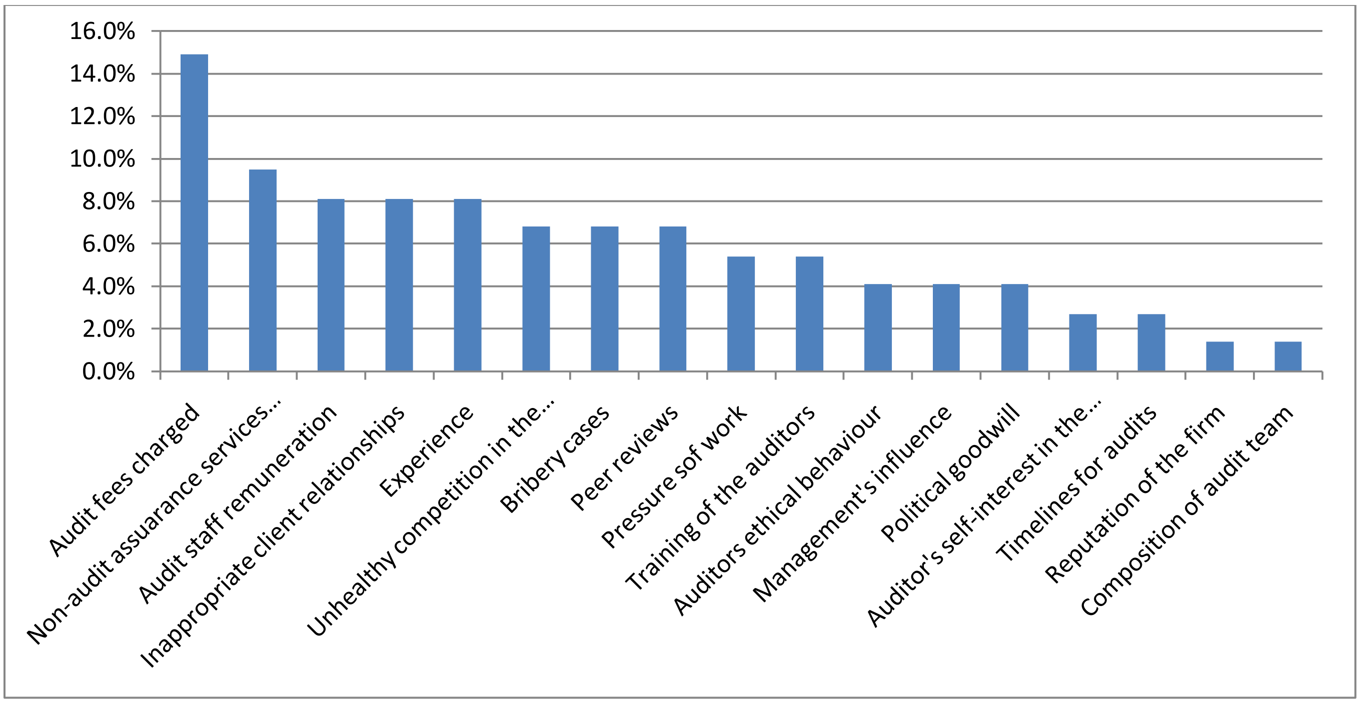

Figure 7: Other factors that influence auditors' independence

Source: Author 2016

Ways to eliminate the threats to auditor independence

The research sought to establish the ways that can be used to overcome the threats that impair auditors' independence. 36% agreed that relying on self-regulation and self-independence, while 45% of all the respondents believed strengthening supervision and management would overcome the threats. Also, regulating competition was seen as a solution by 39% of the respondents, while 53% believed increasing penalties for violations would improve auditors' independence. Further,

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51% believed that more training of auditors would help overcome the vices in the industry while 61% believed that regulations should be formulated to impose a rotation system among the auditors.

Table 8: Ways to eliminate threats that impair auditors' independence

Variable		Frequency	Percentage
Relying on self-regulation and self-independence	Yes	35	36.1
Strengthening supervision and management	Yes	44	45.4
Regulating competition within the industry	Yes	38	39.2
Increasing penalties for violations	Yes	51	52.6
Emphasising on the training of auditors	Yes	49	50.5
Formulating regulations to impose an auditor rotation system	Yes	59	60.8

Source: Author 2016

Regression Analysis

Regression analysis was performed to determine the relationship between audit independence and audit tenure, audit committee and audit firm size. The results of a linear regression are presented below.

Table 9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.329a	0.108	0.079	0.802

a Predictors: (Constant), Audit_comm, Audit_Firm_size, Audit_tenure

From the table above, it shows the model summary with R^2 =0.108 showing that the independent variables predicted 11% of the outcome; audit tenure, audit committee, and audit firm size. The remaining 89% can be explained by other variables not included in the model. This means that 11% of the change in audit independence can be occasioned by the internal factors in the study.

Table 10 further presents the results of ANOVA that explains how well the regression equation fits the data. The results show that the regression model predicts the change in audit independence significantly well as demonstrated by the significance value of 0.013. This is further sup-

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ported by the model F- statistic that is greater than 1(3.757). This indicates that the effects were statistically significant, and therefore the growth is not by chance.

Table 10: ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.254	3	2.418	3.757	.013b
	Residual	59.859	93	0.644		
	Total	67.113	96			

a Dependent Variable: Auditors level of independence

b Predictors: (Constant), Audit_comm, Audit_Firm_size, Audit_tenure

Source: Author 2016

Table 11: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.241	0.374		8.677	0
	Audit_tenure	-0.279	0.101	-0.28	-2.747	0.007
	Audit_Firm_size	0.162	0.082	0.198	1.985	0.05
	Audit_comm	-0.146	0.078	-0.189	-1.88	0.063

a Dependent Variable: Auditors level of independence

Source: Author 2016

The coefficients analysis gives $\beta0$ (Beta) at 3.241, β_1 at -0.279, β_2 at 0.162 and β_3 at -0.146. Where $\beta0$ is the constant, $\beta0$, $\beta_{1,}$ β_2 and β_3 are parameters for estimation of the independent variables; audit tenure, audit firm size and audit committee respectively. From our regression equation;

$$Y= \beta0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$$

Where audit tenure, is denoted by X1, audit firm size by X2 and audit committee as X3 while audit independence is Y, the regression equation of the model becomes;

$$Y =3.241 - 0.279+ 0.162-0.146$$

It is evident from the above regression model that if all independent factors were to be held constant, then the change in audit independence would increase by 3.241.

The regression coefficient of audit tenure was negative and significant in predicting the auditor's independence. This implies that an increase in audit tenure results in decrease in auditor's independence by 0.279. The findings of the study are consistent with the results of Chia-Ah and Karlsson (2010).

The regression coefficient of firm size was positive and significant in predicting the auditor's independence. This result could be attributed to what Hislop (2005) argues that increase in audit firm size reduces dependency on clients for other non-audit service and this has the potential to increase auditor's independence. This implies that an increase in firm size results in increase in auditor's independence by 0.162. These results are similar to the findings Alexander and Hay (2013) who established that networks improve the performance of firms.

The regression coefficient of audit committee and auditor's independence was found to be non-significant in the study as indicated by p-value of 0.063. This could be attributed to what Sharma and Iselin (2012) labels as different components of audit committee have varied effects on audit independence.

Summary of Findings

The research was carried out on the effect of internal factors on Audit independence of Audit firms in Nairobi County. The research instrument was mainly through questionnaires for primary data. Multiple regression and correlation analyzed the data. The target population was auditors in Nairobi County of which responses came from auditors in big and small firms. The regression model in the study and previous research findings illustrates this. Auditors from small firms represented a bigger portion of the responses at 59% with the remaining 41% being auditors from big firms. A detailed analysis of the findings is provided in the continuing sections.

The study sought to find out the relationship between audit tenure and audit independence. The study tested the hypothesis that there is no statistically significant relationship between audit tenure and audit independence among auditors in Kenya. This was tested by correlation analysis tests, with the results of the study indicating that there is a significant relationship between audit tenure and audit independence. This was indicated with a p-value of 0.007. The results also showed that the relationship between audit tenure and audit independence is a weak positive relationship as indicated with a beta value of -0.279. Thus, the null hypothesis is rejected in the study.

On the second objective that was to establish the relationship between audit committee and audit independence, the study tested the hypothesis that there is no significant relationship between

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audit committee and audit independence. The findings of the study indicated that there is no significant relationship between audit committee and audit independence as shown by a p-value of 0.063. Thus, the null hypothesis that audit committee is not significantly related to audit independence is accepted.

On the third objective of the study which was to establish the influence of audit firm size on audit independence in Kenya. To test this objective, the hypothesis that there is no statistically significant relationship between audit firm size and audit independence. From the study results, it was established that there is a statistical relationship between audit firm size and audit independence. A p-value of 0.05 indicated this. Additionally, the results indicated that the relationship between audit firm size and audit independence is a weak positive relationship of 0.162.

Respondents from the summary data indicated that predictor variables cause changes in dependent variable by 10%. 90% of the variation in the dependent variable is due to error term of the model and other factors not in the model. The model is statistically significant as indicated by the F-statistics 3.757 with a significant value of 0.013.

Conclusions

Factors including; the size of an audit firm and the audit tenure are perceived by auditors in Kenya to be having negative and a positive relationship respectively with auditor independence. In particular, auditors perceived that the larger the size of an audit firm, the more likely the firm would face challenges of audit independence.

On the contrary, the study established that the longer the tenure, the more independence the auditor would have while carrying out their work. This could be attributed to the reason that long tenure enables the establishment of structure and relationship that big audit firms can rely on to ensure increased audit independence. However, these findings must be interpreted with caution for the reason that a majority of the respondents were from large audit firms and thus the possible bias in the study results.

The research findings also conclude that audit committee does not influence audit independence in Kenya. However, these findings must be interpreted within the context of the experience of the auditors in the study, where a majority of them had less than five years' experience and thus may not be well versed with audit among the small firms. The results of this study indicate that the respondents seemed not aware of the importance of the audit committee to be able to read, analyse and interpret the financial statements so that they would be able to perform their function effectively. As argued by Carcello and Neal (2003), an audit committee will be more likely to understand and support auditors' decisions (i.e. to issue a GC report) and will be more effective in preventing management from dismissing its auditors subsequent to the issuance of the report. Thus, the understanding of the role of audit committee on audit independence is crucial in shaping the perception of auditors on audit independence.

Recommendations of the study

Given the rapid changes in the economy that increase business risk, there is need to establish more and strong audit committees with "much more time" to effectively perform their duties. It has been determined that majority of respondents were not acquainted with the role of audit committee, and thus audit committee need to be entrenched in firms.

There is a need for ICPAK to develop rules that will guide audit rotation among auditors working for any given client. This will help restore professionalism, accountability, and integrity in the work of auditors.

Given the recent cases where large audit firms have been involved in falsification of accounts, there is a need for ICPAK to develop policies and rules that will enhance the independence of both big and small firms.

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