AUDIT COMMITTEE ATTRIBUTES, INTERNAL CONTROL FRAMEWORK AND FINANCIAL REPORTING QUALITY OF THE STATE-OWNED COMMERCIAL ENTERPRISES IN KENYA

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Abstract

The paper examines how internal control framework intervene the relationship between audit committee attributes and financial reporting. The study applied secondary data extracted from annual reports and audited financial statements of the state-owned commercial enterprises in Kenya between 2008 and 2018 which were analysed using panel data regression models and adoption of Baron and Kenny (1986) approach. The study contributes to the literature by investigating the intervening effect of internal control framework on the relationship between audit committee attributes and financial reporting of state-owned commercial enterprises in Kenya. The results reveal that internal control framework had no significant intervening effect on relationship between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. The results further indicate that internal control framework had no intervening impact on the relationship between audit committee attributes and accrual quality as well as with qualitative characteristics of the state-owned commercial enterprises in Kenya. While the

results couldn't be representative for all state-owned entities because of its narrow focus on state-owned commercial enterprises, additional studies could be conducted incorporating all state-owned entities.

Keywords: Audit Committee Attributes, Internal Control Framework, Financial Reporting, State-owned Commercial Enterprises

INTRODUCTION

The oversight roles of audit committee over financial reporting process has been brought to question in the recent past and the demand for strong corporate governance mechanisms including effective internal control system has been in the rise (Mohiuddin & Karbhari, 2010) due to the incidents witnessed involving accounting impropriety (Enron; WorldCom). Financial reporting stakeholders leverage on quality financial information disclosures in audited financial statements and annual reports. Moreover, Bedard and Gendron (2010) argue that independent audit committee meeting frequently improves quality of financial information disclosure while sustaining financial reporting quality. Chen et al, (2008) and Turley and Zaman (2007) assert that audit committee contributes to oversight while mitigating shareholders' engrossment in firms and does not reflect on the impact of internal control framework on the association between audit committee attributes and financial reporting quality (Wallace and Nasser, 1995) of state-owned commercial enterprises as noted by Wallace and Nasser (1995).

Various theories have been applied in audit committee research delineating from well-defined conditions including economics, psychology, sociology and legal. The legal setting contend that law and regulations decree roles and responsibilities of audit committee and agency theory advancing that over-sighting management by audit committee reinforce quality of financial information reporting process and disclosure (Bedard and Gendron, 2010). Bedard and Chi (1993) claim that expertise paradigm as a psychological perspective integrated with the institutional theory affirms the influence that internal control framework on the relationship between audit committee qualification and financial reporting quality. Additionally, Turley and Zaman (2007) argue that relationship between audit committee and financial reporting quality may be impacted as backed by power theory.

Audit Committee Attributes

Augmentation in regulatory and stakeholder dictates have resulted into admission that audit committee attributes as a major integrant in corporate governance structure. DeZoort et al., (2002) note that audit committee attribute impact operations and effectiveness of audit

committee considered as a complement with expertise and capability to protect shareholder's interest by indemnifying invariable financial reporting and effective internal controls. In addition, Sarbanes Oxley Act (SOX) (2002, 205) acknowledge that audit committee is charged with role of providing oversight over financial reporting processes and internal control system.

SOX (2002) observe that independent audit committee contemplate inviolable in effective internal controls and improve potent monitoring of financial reporting process underpinning its oversight responsibility over financial reporting. Audit committee is viewed as sustaining boards in superintending integrity of financial statements, control requirements, and engagement of independent auditor in addition to the qualification and independence, and performance of the internal audit function leveraged by effective institutional structures as buttressed by institutional theory (Woodlock, 2006).

Internal Control Framework

Organizations must have strong internal control framework to enhance financial reporting quality. Committee of Sponsoring Organization of Treadway Commission (COSO, 1992, 2004) describe internal control framework as data structure that organize and categorize an establishment's of internal controls consisting of practices and processes recognized to generate business value to reduce risk. Internal control is a process effected by an entity's board, management and personnel to deliver reasonable assurance of the achievement of an organization's objectives on effectiveness and efficiency of processes, reliability of financial reporting and compliance with laws (COSO, 2013, 2017; Rautenstrauch & Hunziker, 2011).

Firms disclose internal control framework components in annual reports and audited financial statements which provide confidence to financial reporting users. COSO (1992) contend that prospective stockholder has a justifiable interest with regard to the extent with which management's accountability for the firm's financial statements and effective internal control framework disclosures relating to control environment, risk assessment, control activities, information and communication and monitoring contributes to the foundation for sound internal control system. McMullen, Raghunandan and Rama (1996) in their study in examining annual reports of about 4154 companies (1989-1993) observe that internal control framework components' disclosure is adversely linked to poor financial reporting. Further, Ge and McVay (2005) posit that deficiencies in internal control have positive correlation with complexity of business while adversely related to the firm size and profitability.

Existing literature on internal control framework shows that researchers and rating agencies (Standard & Poor & CI-FAR index) have employed various methodologies including content analysis in measurement of internal control disclosure in annual reports (Leng &

Ding, 2011) using internal control disclosure index (ICDI). The research adopted content analysis to establish the ICDI to measure disclosure quality. The selection of items to be used were guided by COSO framework which included statements about the management commitment to integrity and ethical values; management responsibility in identifying risks and analyzing their impacts on firm's objectives; deployment of control activities; effective communication of objective and responsibilities on internal controls; and evaluation and communication of control deficiencies for feedback. Mwongozo Code (2015) requires the board and management of State-owned Commercial Enterprises to disclose the efficiency of internal control in their annual reports. The study applied control environment, control activities, risk assessment, information and communication and monitoring as measures of internal control framework. This was consistent with the previous studies (Matari et al., 2017; Khlif & Samaha, 2016).

Financial Reporting Quality in State-owned Commercial Enterprises

Financial reporting quality is a key factor among financial reporting stakeholders including regulators, practitioners and other users of financial reporting information while it remains the dominant means for disseminating performance of the companies to stakeholders. Contrarily, Pomeroy and Thomton (2008) contend that scholars, regulators and practitioners favour faultless financial reporting process. In addition, Martinez-Ferrero (2014) demonstrate quality financial reporting as an indicator of faithfulness of the information as reflected in the financial reporting process. Furthermore, SOX (2002) demand audit committee to confirm the quality of financial reporting methodology applied and not discredit and fails to demystify what incorporate financial reporting quality. Consequently, IASB (2008) consummate that the quality of financial reporting quality is adjudicated through meeting the objectives and qualitative characteristics of financial reporting.

Notwithstanding Beasley (1996) notes that financial reporting contributes towards management's stewardship, entity's assets, liabilities, equity, income and expenses, commitments and disbursements to shareholders, undoubtedly, IASB (2010) assert that relevance and faithful representation of financial information are key qualitative characteristics of financial statements and financial reporting is anticipated in disseminating information on useful investment, credit and resource allocation decisions. Immeasurable researchers (Bushman and Smith, 2001; Healey and Palepu, 2001; Lambert et al., 2007) have employed accrual and value relevance models strengthening earnings quality while are and some are bedeviled on conclusive characteristics in annual reports and methodologies operationalizing qualitative characteristics.

Vantendeloo and Vansstrealen (2005) confirm that accrual models only apply financial information while ignoring non-financial information in annual reports. In addition, it has been argued that earning persistence, timeliness in reporting, audit fees charged, disclosure quality and adoption and compliance with the international financial reporting standards' (IFRS) prerequisites direct financial reporting quality (Biddle and Hillary, 2006 and Lambert et al., 2007). The studies affirm hat financial reporting quality pursues preeminent origin of extrinsic information to divergent financial reporting stakeholders. State-owned commercial enterprises in Kenya have adopted the International Financial Reporting Standards framework given their commercial nature.

State-owned Commercial Enterprises

Researchers have delineated state-owned commercial enterprises (SOCEs) as organizations established exclusively or by controlling majority shareholding by government and/or its organisations or a body incorporated by an Act of parliament to fulfil commercial goals (OECD, 2005a, 36; Wamalwa, 2003 and PTPR, 2013). Weak corporate governance structures and ineffective audit committees characterized by inaccurate financial reporting have been experienced in the SOCEs as revealed by increment in financial restatements (Ogoro and Simiyu, 2015), Public Investment Committee (PIC), Public Accounts Committee (PAC) and Auditor General's reports (2013-14, 2014-15, 2015-16, 2016-17 and 2016-2018). Many SOCEs has experienced misappropriation of financial resources, bad governance and ineffective oversight over financial reporting leading to questions on competence, capacity and effectiveness of audit committees in contributing to effective oversight on governance, control and quality financial reporting processes and reports.

Despite of intelligibility on financial reporting framework and numerous legislation, weakness in governance, accountability, efficiency and effectiveness in application of resources has been considered overload to the citizen even when the constitution, Public Finance Management Act 2012 and Public Finance Management Regulations 2016 establishing audit committees in the public sector. Whereas numerous governance structures established including audit committee and annual audit by the Office of the Auditor General, weaknesses in internal control has continued has been experienced in most SOCEs. Prior studies focused on public listed companies and private sector entities and therefore, making state-owned commercial enterprises to be identified for this study.

Research Problem

Many financial statements stakeholders including regulators, scholars, investors and Practioners have questioned the quality of financial reporting and the role of other oversight bodies such as audit committees and the focus has been on the public listed companies (Warren & Reeve, 2004; Bedard & Gendron, 2010). Zhou et al. (2007) observe that companies with audit committee members without financial and accounting expertise exhibited internal control weakness and poor financial reporting quality. Further, Ge and McVay (2005) argue that disclosure of material weakness related affirmatively to business combination with contradicting result with firm size.

While audit committee is charged with providing oversight over financial reporting and internal control in state-owned commercial enterprises, Doyle, Ge and McVay (2007) assert that connection of weak internal controls and low accrual quality was affected by ineffective disclosure of internal controls. Weak internal control system has been witnessed to impact negatively on the relationship between audit committee and financial reporting quality. Doyle et al (2007) imply that internal control weakness is mainly connected to indigently approximated accruals not realized as cash and the study is limited to private sector. McMullen and Raghunandan (1996) claim that organisations encountering financial reporting challenges had audit committee members with no accounting qualification while those with quality financial reporting had a CPA in their committee. The study sought to address the effect of internal control framework had on the relationship between audit committee and financial reporting quality of the state-owned commercial enterprises in Kenya.

LITERATURE REVIEW

While the board is in charge of corporation's internal control system and its effectiveness, audit committee provides oversight on Internal Control framework (ICF) and assurance on its effectiveness. While there was inadequate empirical literature on the contributing factors of internal control quality prior to Sarbanes-Oxley Act, Krishnan (2005) in his empirical investigation of audit committee attributes and internal control in listed firms in the NYSE indicate that audit committee independence and financial expertise is significantly linked to strong internal controls and financial reporting quality. Hunziker (2013) explored internal control disclosures within a sample of 91 Swiss listed non-financial firms through advancement of an internal control disclosure index and conclude that size of audit committee and firm liquidity importantly relate to the quality financial reporting.

Ge and McVay (2005) examined 261 firms that revealed minimal material flaw in internal control in compliance with Sarbanes Oxley Act (2002) in the USA. The study found that disclosure of material weakness related affirmatively to business aggregation and with contradicting result with firm size. Zhou et al. (2007) investigated relationship amongst audit committee attribute of independence and internal control weakness after the enactment of Sarbanes-Oxley Act (2002). They used conditional logit analysis and found that organizations with audit committee members with less financial and accounting expertise experienced internal control weakness and poor financial reporting quality.

Doyle, Ge and McVay (2007) surveyed the relationship between accrual quality and internal control using 705 businesses listed in the NYSE for a period between 2002 and 2005. The study used regression analysis and found out that connection of weak internal controls and low accrual quality was affected by ineffective disclosure of internal controls. Doyle and McVay (2007a) tested causalities of deficiencies in internal control 779 organizations for a period of four years and found that smaller firms have serious internal control weaknesses while young growth organizations disclose more internal control weaknesses improving their quality of financial reporting. They further argued that sizeable businesses may experience supplemental structured financial reporting proceeding and course of action which enhance segregation of duties.

While Eng and Mak (2003) analyzed the link amongst firm specific characteristics with discretionary disclosures and assert that lessened organizational and powerful government takeover are related to improved voluntary disclosure, Hunziker (2013) argue that firm specific characteristics resulting from agency theory expressly explain the inconsistency in the level of voluntary disclosure on controls. Further, Doyle et al (2007) suggest that internal control weakness is largely linked to poorly estimated accruals not realised as cash and the study is limited to private sector. McMullen and Raghunandan (1996) claim that companies experiencing financial reporting problems did not have audit committee members with accounting qualification while those with quality financial reporting had a CPA in their committee. The literature reviewed examined the intervening effect of internal control framework on the relationship between audit committee attributes and financial reporting quality of State-owned commercial enterprises in Kenya and tested the following hypothesis.

H₀: Internal Control Framework has no intervening effect on the relationship between Audit Committee Attributes and Financial Reporting Quality of state-owned commercial enterprises in Kenya

RESEARCH METHODOLOGY

The study examined the intervening effect of internal control framework on the relationship between audit committee and financial reporting quality of the state-owned commercial enterprises in Kenya. The research employed control environment (ICF_CE), risk assessment (ICF_RA), control activities (ICF_CA), information & communication (ICF_IC) and monitoring (ICF_MN) representing internal control framework; independence (AC_IND), qualification (AC_QUA), size (AC_SIZ) and number of meetings held in a year (AC_MEET) were used as audit committee attributes. Further, accrual quality (AQ), qualitative characteristics (QC) and timeliness reporting were applied to test for financial reporting quality. The data analyzed were obtained from the audited financial statements and annual reports of the 122 state-owned commercial enterprises for a period of 11 years between 2008 and 2018 due to completeness of the data for state-owned commercial enterprises selected for this research.

The study applied Baron and Kenny (1986) approach where four stage tests were employed to conduct an evaluation of the mediating effects of internal control framework on interconnection amongst audit committee attributes with financial reporting quality and the following models were applied in testing the hypothesis. Baron and Kenny (1986) infer a three-variable system involving two causative bridleways contributing to result variable. In the first step, a regression analysis was performed to examine the association between financial reporting quality and audit committee attributes without considering intervening variable.

$$FRQ_a = \beta_0 + \beta_1 ACA + u_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (1)$$

Where:

FRQ_a – Financial Reporting Quality

β_0 – intercepts

β_{1-n} – Coefficient of independent variables

ACA – Composite score of audit committee attributes computed as a geometric mean of the audit committee attributes

Multivariate examination was carried out in step two to scrutinize association amongst internal control framework and AC attributes without incorporating FRQ. The following model was employed in the exploration.

$$ICFit = \beta_0 + \beta_1 ACA + u_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (2)$$

Where:

ICF   Composite measure of ICF to be determined as a geometric mean of the components of internal control framework

FRQ_a, β_0, β_1 as defined in step one

A mediation analysis was tested in third stage through a regression analysis to evaluate association amongst IC framework and FRQ through ignoring independent variable using the following regression models.

$$FRQit = \beta_0 + \beta_1 ICF + u_{it}\dots \dots\dots \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(3)}$$

Where:

FRQ_a, β_0, β_1 as defined above; ICF as defined in step two

In the last step mediation analysis was performed through a regression analysis to measure the link amongst FRQ, Internal Control Framework and AC attributes using the following regression models.

$$FRQ_a = \beta_0 + \beta_1 ACA + \beta_2 ICF + u_{it}\dots\dots\dots\dots\dots\dots\dots\dots\dots \text{(4)}$$

Where:

FRQ_a, β_0, β_1 as defined in step one ICF and ACA defined in steps 2 and 1.

Mediation occurs only when audit committee attributes estimate financial reporting quality, audit committee attributes predicts Internal Control Framework, Internal Control Framework predicts FRQ while AC Attributes forecast Financial Reporting Quality when Internal Control Framework exists in the model.

FINDINGS

Descriptive statistics

The research applied descriptive statistics to analyse and summarize the study variables. The data covered 122 state-owned commercial enterprises for the period between 2008 and 2018. The study findings in Table 1 reveal that audit committee size in the state-owned commercial enterprises in Kenya (SOCEs) ranged from 4 to 6 members, with an estimated mean of five (*mean=5.11*) members. In addition, the outcome indicated the number of independent members in audit committee ranged between 2 and 5 members with an approximate mean of 2 (*mean=2.95*) members while those with accounting/finance expertise 1 and 3 members with a mean of 2 (*mean=1.81*) members. The number of audit committee meetings held in a year stood between 3 and 9 with a mean of 6 (*mean=6.46*) meetings in year.

Table 1: Descriptive Statistics for Audit Committee Attributes

Variable	N	Mean	S.D.	Min	Mdn	Max
Audit Committee Independence	1342	2.95	0.63	2	3	5
Audit Committee Qualification	1342	1.81	0.59	1	2	3
Audit Committee Size	1342	5.11	0.49	4	5	6
Audit Committee Meetings	1342	6.46	1.18	3	6	9

Table 2 shows that ICF_CE, ICF_CA, ICF_RA, IC_IC and IC_MN had a mean of 3.25, 1.81, 3.54, 2.54 and 1.71 with standard deviation of 0.76, 0.45, 0.57, 0.69 and 0.47 respectively. The mean values of 3.25, 1.81, 3.54, 2.54 and 1.71 for ICF_CE, ICF_CA, ICF_RA, IC_IC and IC_MN respectively indicate that SOCEs have strong control environments achieved through disclosures in the annual reports and financial statements of an obligation to probity and morality, independence of boards, holding individual responsible for their internal control accountabilities and establishing effective and efficient oversight structures. Equally the results indicate that have effective control activities and monitoring in respective SOCEs where they select and develop ICF_CA commit conclusively lessening of threats and opportunities geared toward accomplishment of the intent acceptable in respective institution as well as strong evaluation structures for their internal control deficiencies and communicate adequately to the stakeholders. In addition, the results show that SOCEs identified risks continuously that may affect the implementation of their objectives including risks of fraud while generating quality data in support of the internal control and communication to external stakeholders in regard to efficacy and coherence of the IC structure.

Comparatively, the results indicated standard deviation values of 1.81, 3.54, 2.54 and 1.71 respectively for ICF_CE, ICF_CA, ICF_RA, ICF_IC and MN implying that large variation in the efficacy and competence of IC procedure of SOCEs subjected to the study.

Table 2: Descriptive Statistics for Internal Control Framework

Variable	N	Mean	S.D.	Min	Mdn	Max
Control Environment	1342	3.25	0.76	1	3	4
Control Activity	1342	1.81	0.45	0	2	2
Risk Assessment	1342	3.54	0.57	2	4	4
Information & Communication	1342	2.54	0.69	0	3	3
Monitoring	1342	1.71	0.47	0	2	2

Correlation between Audit Committee Attributes and Internal Control Framework

The relationship between AC attributes (determined by independence, size, and qualification along with meetings held in a year) and internal control framework (measured by the ICF_CE, ICF_CA, ICF_RA, ICF_IC and monitoring) was assessed using the Pearson correlation analysis. The results in Table 3, indicate statistically significant negative association between control environment with both audit committee independence (r=-0.0797, $p < 0.05$) and audit committee qualification (r=-0.2267, $p < 0.05$). The same was depicted between information and communication and audit committee independence (r=-0.0786, $p < 0.05$) while it had statistically significant and indisputable correlation with audit

committee qualification. This indicated that increase in members of the AC members with accounting/finance expertise improved the information provided in the financial statements and annual reports and communication feedback amongst the audit committee and management.

Equally the results showed that Control Activities had significant positive correlation with AC independence (r=0.1045, p<0.05) and size of the audit committee (r=0.1421, p<0.05) respectively. This implied that control activities in the state-owned commercial enterprises were enhanced with the increase in number of independent AC members. The argument for the agency theory is supported since independent audit committees are noted to reduce information asymmetry by instituting strong internal controls (Godwin, 2004). It was also observed that monitoring as one of the components of internal control framework had a statistically significant conclusive interdependence with control activities (r=0.01317, p<0.05) indicating that with effective monitoring enhances control activities in these institutions.

Table 3: Pearson Correlation between Audit Committee Attributes
and Internal Control Framework

Variables	AC_IND	AC_QUA	AC_SIZ	AC_MEET	ICF_CE	ICF_CA	ICF_RA	ICF_IC	ICF_MN
AC_IND	1								
AC_QUA	0.2641*	1							
AC_SIZ	0.0105	0.2609*	1						
AC_MEET	-0.0336	0.2085*	-0.0066	1					
ICF_CE	-0.0797*	-0.2267*	-0.0261	-0.0177	1				
ICF_CA	0.1045*	0.0249	0.1421*	0.0315	-0.038	1			
ICF_RA	0.0587*	0.0334	0.0729*	-0.0772*	0.1268*	0.0067	1		
ICF_IC	-0.0786*	0.1581*	-0.0011	-0.0096	-0.0468	0.0152	-0.0229	1	
ICF_MN	-0.0074	0.0076	0.0452	0.0018	0.0233	0.1317*	0.0418	0.0128	1

*. Correlation is significant at the 0.05 level.

Hypothesis Testing

The objective of the study was to examine the mediation effect of internal control framework on the association between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. The mediation effect was assessed through application of the technique initiated by Baron and Kenny (1986) where four steps were used to examine the intervening effects of the intervening variable on the association between the predictor and predicted variables. In the first step of the intervening model, panel regression was conducted to evaluate the interconnection of financial reporting quality

with audit committee attributes ignoring the internal control framework. In step two of the intervening procedure, regression was carried out in examining association among internal control framework and AC attributes ignoring FRQ. In the third step, regression analysis was carried out to evaluate the connection that internal control framework had with financial reporting quality ignoring the predictor variable (audit committee attributes). Step four involved investigation of the panel to examine the interdependence amongst FRQ, IC Framework and audit committee attributes.

Baron and Kenny (1986) assert that intervention only occurs when the four conditions are met and that there must be a significant correlation between independent and dependent variables in absence of the intervening variable. In addition, there must be a significant association among the predictor and mediating variables as well as significant association between the mediating and explained variable. Finally, predictor variable has insignificant effect on the dependent variable while controlling for the influence of the intervening measure on the dependent variable.

To determine the mediation effect of internal control framework on the relation among audit committee attributes and financial reporting quality, the following hypothesis was tested.

H_0: Internal Control Framework has no intervening effect on the relationship between Audit Committee Attributes and Financial Reporting Quality of state-owned commercial enterprises in Kenya

Audit committee independence was used as proxy for audit committee attributes while the results of Hausman test indicated that random effects model was the preferred model.

Table 4: Panel Random–Effects Regression Results, Dependent Variable:
Financial Reporting Quality, Predictors: Audit Committee Attributes (AC_IND)

	(1)
VARIABLES	Model 1
AC_IND	0.0113*
	(0.00607)
Constant	0.101***
	(0.0179)
Observations	1,165
R-Squared	0.0259
Wald chi2(2)	3.45
Prob > chi2	0.0633
Number of SOCE_ID	108

Robust standard errors in parentheses

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

The panel Random Effect model was run in the first step of the analysis to estimate the interconnection of financial reporting quality with AC independence while ignoring the internal control framework. The results of panel regression analysis were as displayed in Table 4. Findings of Wald Chi-Square evaluated indicated that model 1 as a whole was not significant. It was noted through analysis that the model regression coefficient of audit committee independence (β= 0.0113, p<0.1) was however statistically significant. Meanwhile, R-squared (R^2) was 0.0259 which implied that audit committee independence accounted for about 2.59% of the variance in FRQ. Further, the results revealed that AC independence was a significant predictor variable (p<0.1) demonstrating that a significant association exited between AC attributes and FRQ.

Table 5: Panel Random–Effects Regression Results, Intervening Variable: Internal Control Framework, Predictor: Audit Committee Attributes (AC_IND)

VARIABLES	(1) Model 1
AC_IND	-0.0545
	(0.0670)
Constant	13.05***
	(0.203)
Observations	1,165
F-Statistic	0.66
Prob > F	0.4158
R-squared	0.001

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

A further analysis was undertaken in step two of the model, where panel regression was executed in evaluation of the association between internal control framework and audit committee attribute ignoring financial reporting quality. The regression model was found to be statistically significant as shown in Table 5.

In depth analysis of panel regression model showed that R^2 was 0.001 F (1, 1165) = 0.66, p >0.01. Audit committee independence explained 0.1% of the variance in internal control framework and its regression coefficient was -0.0545 which was not statistically significant (p>0.01) as shown in Table 5. The results explained that AC independence was not a significant predictor variable (p>0.05) and therefore, there was no significant relationship between audit committee independence and internal control framework.

In step three, analysis was conducted to examine the association among internal control framework and FRQ ignoring AC attributes. Outcome panel regression was as presented in

Table 6. From the results shown, Wald Chi-Square test indicated that the model as a whole was not significant. Furthermore, the model regression coefficient of internal control framework (β= 0.00247, p>0.05) was not statistically significant while R-squared (R^2) was 0.0063 which implied that internal control framework accounted for about 0.63% of the variation in financial reporting quality. The evidence revealed that internal control framework was not a significant predictor variable and therefore, there was no significant relationship between internal control framework and FRQ.

Table 6: Panel Random–Effects Regression Results, Dependent Variable: Financial Reporting Quality, Predictor: Internal Control Framework

VARIABLES	(1) Model 1
ICF	0.00247
	(0.00280)
Constant	0.103***
	(0.0364)
Observations	1,165
R-Squared	0.0063
Wald chi2(1)	0.78
Prob > chi2	0.3772
Number of SOCE_ID	108

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The fourth step of the mediation model was undertaken where panel regression analysis was conducted to assess the association between FRQ, internal control framework and AC independence. The results of panel regression analysis were shown in Table 7 where Wald Chi-Square analysis showed that the model as a whole was not significant. The outcome of this study showed that audit committee independence (β= 0.0114, p<0.1) was a significant predicator of financial reporting quality. However, the model regression coefficient of internal control framework (β= 0.00261, p>0.05) was not reliably significant and strengthening position that internal control framework had no significant influence on financial reporting quality. R-squared (R^2) was 0.0328 which demonstrated that audit committee independence and internal control framework jointly accounted for about 3.28% of the variance in FRQ.

Table 7: Panel Random–Effects Regression Results, Dependent Variable: Internal Control Framework, Predictor: Audit Committee Attributes (Audit Committee Independence)

VARIABLES	(1) Model 1
AC_IND	0.0114*
	(0.00602)
ICF	0.00261
	(0.00283)
Constant	0.0672*
	(0.0396)
Observations	1,165
R-Squared	0.0328
Wald chi2(2)	4.69
Prob > chi2	0.0960
Number of SOCE_ID	108

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

To evaluate the direct effect, investigation through panel data was administered to test if predictor variable was correlated with the dependent variable. This was necessary to establish if there was an effect that could be intervened. The results of Wald Chi-Square test indicated that model 1 as a whole was not significant and the model regression coefficient of audit committee independence (β= 0.0113, p<0.1) was however statistically significant. In addition, R-squared (R^2) was 0.0259 which implied that audit committee independence accounted for about 2.59% of the variation in FRQ.

To establish if the mediation effect existed in the relationship between FRQ and AC Independence, the model was expected to be statistically significant in the first step of the mediation model meaning the influence of AC attributes on FRQ controlling for the mediator should be statistically significant. However, study results have indicated that the relationship was not statistically significant (p>.05) although the association between audit committee independence was statistically significant. Furthermore, the causal variable (audit committee independence) should be correlated with the mediator and the relationship should be statistically significant (step 2 of the mediation model) to satisfy the mediation requirement.

Study results have indicated that model was not statistically significant (p>.05). While the third step of the mediation test, the association between the mediator and the dependent variable should be statistically significant, the study results however, have indicated that the association between financial reporting quality and internal control framework was not statistically significant (p>.05). Further, the results demonstrated that the relationship between

financial reporting quality, audit committee independence and internal control framework was also not statistically significant. It is therefore, evident that internal control framework had no intervening effect in regard to the relation among AC attributes and FRQ of SOCEs in Kenya, hence acceptance of the null hypothesis.

For further examination of the mediation effect of internal control framework on the association between AC attributes and FRQ of the SOCEs in Kenya, two additional sub-hypotheses were developed and tested. The following was the first sub-hypothesis to be tested.

H_{01}: *Internal control framework has no intervening effect on the association between AC attributes and accrual quality of the SOCEs in Kenya*

Audit committee qualification (AC_QUA) was used as a measure of AC attributes in the analysis.

Table 8: Panel Regression Results, Dependent Variable: AQ, Predictor:
Audit Committee Attributes (AC_QUA)

VARIABLES	(1) Model 1
AC_QUA	102.0***
	(27.77)
Constant	-36.57
	(51.42)
Observations	1,164
F(1, 1162)	13.49
Prob > F	0.0003
R-squared	0.011

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

In the first step of the regression model, panel Random Effect model was run to estimate the relationship between FRQ, AC attributes where accrual quality and AC qualification were used as proxies for FRQ and AC attributes respectively while ignoring the internal control framework. The results of panel regression analysis (Table 8) indicated that audit committee qualification had reliably significant and conclusive connection to AQ (β= 102.0, p<0.01) and R-squared (R^2) was 0.011 which denoted that that audit committee qualification (independent variable) accounted for about 1.1% of the variance in financial reporting quality. This revealed that audit committee qualification was a significant predictor variable (p<0.01) demonstrating that significant correlation exited between AC qualification and accrual quality, hence FRQ.

In the second step, an examination of panel data regression was conducted in evaluating the association of internal control framework with audit committee attribute ignoring financial reporting quality. The regression model was noted not to be accurately of magnitude ($p>0.01$) as indicated in Table 9. The panel regression model results further indicated that R^2 =0.0004, $F (1, 1165) = 0.43$, $p >0.01$ while audit committee qualification explained 0.04% of the variance in internal control framework and the regression coefficient of audit committee qualification was -0.0458 and therefore, was not statistically notable ($p>0.01$) as shown in Table 9. The results demonstrates that audit committee qualification was not a significant predictor variable ($p>0.01$), hence no remarkable relations existed amidst AC qualification and internal control framework.

Table 9: Panel Regression Results, Dependent Variable: ICF, Predictor: Audit Committee Attributes (AC_QUA)

VARIABLES	(1) Model 1
AC_QUA	-0.0458
	(0.0700)
Constant	12.97***
	(0.135)
Observations	1,165
F(1, 1163)	0.43
Prob > F	0.5129
R-squared	0.0004

Robust standard errors in parentheses

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

The third step (Table 10) of the intervening model, regression was conducted out to appraise the interrelation of internal control framework (intervening variable) with financial reporting quality (dependent variable) ignoring audit committee attribute (independent variable) where accrual quality was applied as a surrogate of FRQ. The results shows that the model regression coefficient of internal control framework ($\beta= 16.22$, $p>0.05$) was not statistically significant. In addition, R-squared (R^2) was 0.002 which implied that internal control framework accounted for about 0.2% of the variance in accrual quality which represents financial reporting quality. This indicated that internal control framework was not a significant predictor variable and therefore, there was no remarkable association of internal control framework with FRQ.

Table 10: Panel Regression Results, Dependent Variable: AQ, Predictor: ICF

VARIABLES	(1) Model 1
ICF	16.22
	(11.55)
Constant	-66.24
	(149.8)
Observations	1,164
F(1, 1162)	1.97
Prob > F	0.1604
R-squared	0.002

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

In the fourth step of the mediation model, panel regression analysis was conducted to determine the association of FRQ, internal control framework with AC attributes where accrual quality and AC qualification were used as measures of FRQ and AC attributes respectively. Results (Table 11) from the analysis reveal that audit committee qualification (β= 102.7, p<0.01) was a significant predicator of financial reporting quality while the model regression coefficient of ICF (β= 17.00, p>0.01) was not statistically significant and therefore, internal control framework had insignificant influence on FRQ. The finding further indicated that R-squared (R^2) was at 0.013 which implied that audit committee qualification and internal control framework jointly accounted for about 1.3% of the variance in accrual quality which was a measure of financial reporting quality.

Table 11: Panel Regression Results, Dependent Variable: AQ, Predictor: AC_QUA, ICF

VARIABLES	(1) Model 1
AC_QUA	102.7***
	(14.27)
ICF	17.00
	(10.60)
Constant	-257.0*
	(139.7)
Observations	1,164
F(2, 1161)	26.08
Prob > F	0.0000
R-squared	0.013

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

A second sub-hypothesis was developed to test the intervening impact of the IC framework elements on relation among AC attributes and qualitative characteristics of SOCEs in Kenya. Therefore, the following sub-hypothesis was tested.

H_{02}: *Internal Control Framework has no intervening effect on the relationship between AC Attributes and Qualitative Characteristics of the SOCEs in Kenya.*

In the examination of the second sub-hypothesis, AC independence (AC_IND) was used as the proxy for AC attributes.

In the first step of the mediation model, panel Random Effect was run to evaluate the association among qualitative characteristics with audit committee independence while ignoring the internal control framework. The results of panel regression analysis were as presented in Table 12. While the results of Wald Chi-Square test indicated that model 1 as a whole was not significant, the model regression coefficient of audit committee independence (β= 0.0131, $p<0.1$) was however statistically significant. Additionally, the results reveal that R-squared (R^2) was 0.0267 indicating that audit committee independence accounted for about 2.67% of the deviation in FRQ. The findings show that AC independence was a significant predictor variable (β= 0.0131, $p<0.1$) demonstrating that consequential association exited amongst audit committee independence and qualitative characteristics further confirming that AC independence has a significance link with FRQ.

Table 12: Panel Random–Effects Regression Results, Dependent Variable: Qualitative Characteristics, Predictor: Audit Committee Attributes (AC_IND)

VARIABLES	(1) Model 1
AC_IND	0.0131*
	(0.00705)
Constant	0.102***
	(0.0208)
Observations	1,165
R-Squared	0.0267
Wald chi2 (1)	3.44
Prob > chi2	0.0638
Number of SOCE_ID	108

Robust standard errors in parentheses

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

The second step involved analysis of panel data in examining the association of internal control framework (dependent variable) with AC attribute (independent variable) while ignoring FRQ. The results revealed that regression model was not statistically significant ($p>0.05$) with

R^2 = .001, F (1, 1165) = 0.66, p >0.05 while AC independence explained 0.1% of the variance in internal control framework. The regression coefficient of AC independence was -0.0545 which was substantial (p>0.01) as was shown in Table 13.

Table 13: Panel Random–Effects Regression Results, Dependent Variable:

Internal Control Framework, Predictor: Audit Committee Attributes (AC_IND)

VARIABLES	(1) Model 1
AC_IND	-0.0545
	(0.0670)
Constant	13.05***
	(0.203)
Observations	1,165
F-Statistic	0.66
Prob > F	0.4158
R-squared	0.001

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The results exposes that audit committee independence was not a significant predictor variable (p>0.05), hence no significant connection existed between audit committee independence and internal control framework.

Table 14: Panel Random–Effects Regression Results, Dependent Variable:

Qualitative Characteristics, Predictor: Internal Control Framework

VARIABLES	(1) Model 1
ICF	0.00325
	(0.00326)
Constant	0.0993**
	(0.0425)
Observations	1,165
R-Squared	0.0084
Wald chi2 (1)	0.99
Prob > chi2	0.3197
Number of SOCE_ID	108

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

In the third step of the intervening paradigm, regression was carried out to evaluate association of qualitative characteristics with internal control framework ignoring audit

committee attribute. The findings of panel data analysis were as presented in Table 15. From the findings, Wald Chi-Square test reveals that the model as a whole was not significant. The model regression coefficient of internal control framework (β= 0.00325, p>0.05) was not statistically significant while R-squared (R²) was 0.0084 which denoted that internal control framework accounted for about 0.84% of the variation in FRQ. This shows that internal control framework was not a significant predictor variable and therefore, there were insignificant interrelations among internal control framework and FRQ.

Table 15: Panel Random–Effects Regression Results, Dependent Variable: Qualitative Characteristics, Predictor: Audit Committee Independence, Internal Control Framework

VARIABLES	(1) Model 1
AC_IND	0.0133*
	(0.00699)
ICF	0.00341
	(0.00329)
Constant	0.0579
	(0.0461)
Observations	1,165
R-Squared	0.0358
Wald chi2 (2)	4.93
Prob > chi2	0.0851
Number of SOCE_ID	108

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

In step four involved that analysis of the data in evaluating association of FRQ, internal control framework and AC independence. The findings of panel regression analysis were as shown in Table 15 which revealed that Wald Chi-Square test model as a whole was not significant. Further, the study analysis of this study shows that AC independence (β= 0.0133, p<0.01) was a significant predicator of FRQ.

Comparatively, findings showed that model regression coefficient of ICF (β = 0.00341, p>0.05) was not concretely significant leading to the conclusion that Internal Control Framework had insignificant influence on FRQ. The outcome further revealed that R-squared (R²) was 0.0358 indicating that audit committee independence and internal control framework jointly accounted for about 3.58% of the variance in financial reporting quality (dependent variable). From the findings, we conclude that internal control framework had no intervening effect on the

interrelation between AC attributes and FRQ in the SOCEs, and therefore, we fail to reject the null hypothesis.

DISCUSSION

The objective of the research was to determine the effect of Internal Control Framework on the interconnection of AC Attributes and FRQ of SOCEs. The study used ICF_CE, ICF_CA, ICF_RA, ICF_IC and ICF_MN to represent Internal Control Framework; Independence, Qualification, Size, and Meetings conducted in a year represented Audit Committee Attributes while Accrual Quality, Qualitative Characteristics and Timeliness Reporting were used as indicators for FRQ. Random Effect model was used to estimate the association of FRQ (dependent variable) with AC Independence (independent variable) while neglecting the Internal Control Framework in step 1 of the test. The results of panel regression analysis using Wald Chi-Square test indicated that model 1 as a whole was not significant. However, the model regression coefficient of Audit Committee Independence ($\beta= 0.0113$, $p<0.1$) exhibited conclusive and scientifically notable. R-squared (R^2) was 0.0259, further revealing that Audit Committee Independence (independent variable) accounted for 2.59% of the variance in financial reporting quality (dependent variable) hence revealing that Audit Committee Independence was a significant predictor variable ($\beta= 0.0113$, $p<0.1$) demonstrating that significant relationship existed among AC Independence and FRQ.

The results of the second step in the mediation model was used to evaluate the association between Internal Control Framework and AC Attribute while ignoring Financial Reporting Quality which indicated that R-Squared (R^2) was = .001, $F (1, 1165) = 0.66$, $p >0.05$ intimating that AC Independence ($\beta= -0.0545$, $p>0.01$) was insignificant and only explained 0.1% of the variance in the Internal Control Framework. This further explained that AC Independence was insignificant predictor variable ($p>0.05$), hence no consequential association existed between AC and Internal Control Framework. The results of the study shows inconsistency with those of Krishnan (2005) who found out in their empirical investigation that AC independence and qualification (members with financial expertise) had significant link with strong internal controls and FRQ which is supported by those of Hunziker (2013).

Similarly, the third step of the mediation model results where the correlation amidst IC Framework (intervening variable) and FRQ while ignoring Audit Committee Attribute was assessed using Wald Chi-Square analysis which revealed that the whole model was insignificant. Moreover, the model regression coefficient of Internal Control Framework ($\beta= 0.00247$, $p>0.05$) was insignificant. R-squared (R^2) was 0.0063 which implied that Internal Control Framework (mediator) accounted for 0.63% of the variation in FRQ. This indicated that

Internal Control Framework was not significant predictor variable and therefore, there is insignificant connection of Internal Control Framework with FRQ. In their study, Doyle, Ge and McVay (2007) found that firms with ineffective disclosure of internal controls had low accrual quality which was a measure for FRQ, and therefore, the results of the study were found to be in conflict with the current study results. Similar position has been backed by Doyle and McVay (2007a) who contend that small firms with serious weaknesses in internal control disclose more internal control weakness thereby improving their FRQ.

In panel regression analysis in the fourth step of the mediation model to evaluate the relations amongst FRQ, Internal Control Framework with AC Independence using Wald Chi-Square analysis, the results showed that the whole model was not significant. While findings revealed that AC Independence (β= 0.0114, p>0.01) was a significant predicator of Financial Reporting Quality, the model regression coefficient of Internal Control Framework (β= 0.00261, p>0.05) showed that it was not statistically significant and therefore, Internal Control Framework had no significant intervening influence on Financial Reporting Quality. Further, R-squared (R^2) was 0.0328 which revealed that Audit Committee Independence and Internal Control Framework (mediator) jointly accounted for about 3.28% of the variance in Financial Reporting Quality (dependent variable) leading to non-acceptance of the null hypothesis. Furthermore, findings indicated no evidence that internal control framework had significant influence on financial reporting quality. However, Eng and Mak (2003) proffer those firms with voluntary internal control disclosure improving their quality of financial reporting. Hunziker (2013) agrees with the finding by claiming that definite components resulting from agency theory expressly expound inconsistency at a magnitude of discretionary declaration on internal controls.

Additional sub-hypothesis was analyzed in the examination of the intervening effect of IC Framework on the link of AC Attributes to Accrual Quality in SOCEs. In step 1, Panel Random Effect model was run to estimate the interrelations amongst FRQ, AC Attributes where Accrual Quality with AC Qualification were used as proxies for FRQ and AC attributes respectively while ignoring the Internal Control Framework. The results of the analysis reveals that AC Qualification had statistically significant and conclusive association with Accrual Quality (β= 102.0, p<0.01) while R-squared (R^2) was 0.011 which implied that Audit Committee Qualification (independent variable) accounted for 1.1% of the variance in financial reporting quality (dependent variable) and therefore, revealing that Audit Committee Qualification was a significant predictor variable (p<0.01) thereby confirming the existence of connection between AC Qualification and Accrual Quality, hence FRQ.

In step two of the analysis, panel data were explored to evaluate an association existed among Internal Control Framework and AC Attribute while ignoring FRQ. The results showed

that the model was not significant with R-Squared of 0.0004, F (1, 1165) = 0.43, p >0.01 meaning that Audit Committee Qualification explained 0.04% of the variance in Internal Control Framework. Further, the regression coefficient of Audit Committee Qualification was -0.0458 and was not statistically plausible (p>0.01) showing that AC Qualification was not a significant predictor variable (p>0.01), hence no significant relationship existed amidst AC Qualification with IC Framework. This is confirmed by Zhou et al. (2007) in their research which they found out that AC committee with members with less financial and accounting expertise experienced internal control weakness and poor financial reports.

In the third step of the analysis of the intervention panel data were investigated to estimate whether an association existed among Internal Control Framework and FRQ while ignoring Audit Committee Attribute. The model regression coefficient of Internal Control Framework (β= 16.22, p>0.05) was found not to be statistically significant while R-squared (R²) was 0.002 reflecting that Internal Control Framework (mediator) accounted for 0.2% of the variance in Accrual Quality which represented Financial Reporting Quality. This indicated that Internal Control Framework was not a significant predictor variable and therefore, there was insignificant interconnection of Internal Control Framework with FRQ. We further, noted the inconsistency of the results with previous studies (Krishnan, 2005; Hunziker, 2013) which could be attributed to other invisible factors in these SOCEs which might have not been incorporated in the analysis of data.

Lastly, panel data were scrutinized in the appraisal of an association between FRQ, Internal Control Framework and AC Attributes where Accrual Quality and AC Qualification were used as measures of FRQ and AC Attributes respectively. Results from the analysis revealed that Audit Committee Qualification (β= 102.7, p<0.01) was a notable predicator of FRQ while the model regression coefficient of ICF (β= 17.00, p>0.01) was not statistically significant and therefore, Internal Control Framework had no significant influence on Financial Reporting Quality. R-squared (R²) was 0.013 implied that Audit Committee Qualification and Internal Control Framework (mediator) jointly accounted for 1.3% of the variance in Accrual Quality which was a measure of Financial Reporting Quality. We therefore, conclude that Internal Control Framework had no mediation influence on relation between AC Qualification and Accrual Quality; hence acceptance of the null hypothesis.

Another additional sub-hypothesis was analyzed and the first step of the mediation model analysis tested relationship between Qualitative Characteristics and Audit Committee Independence while ignoring the Internal Control Framework using Wald Chi-Square test which indicated that model 1 as a whole was insignificant. Findings further revealed that the model regression coefficient of AC Independence (β= 0.0131, p<0.1) was reliably notable while R-

Squared (R²) was 0.0267 indicating that Audit Committee Independence (independent variable) accounted for 2.67% of the variance in Financial Reporting Quality (dependent variable). This showed that Audit Committee Independence was a significant predictor variable ($p<0.1$) demonstrating plausible association existed between AC Independence and Qualitative Characteristics further confirming that audit committee independence had a significance link with FRQ.

Step 2 of the further analysis of the mediation model was in testing the relationship between Internal Control Framework and Audit Committee Attribute while ignoring Financial Reporting Quality and the result showed a representation not scientifically consequential ($p > 0.05$). The panel regression model produced R^2 = .001, F (1, 1165) = 0.66, p >0.05 indicating that AC Independence explained 0.1% of the variance in Internal Control Framework. Additionally, the regression coefficient of Audit Committee Independence was -0.0545 which was not statistically significant ($p>0.01$) explaining that Audit Committee Independence was not a significant predictor variable ($p>0.05$), hence no significant relation exist between AC Independence and IC Framework.

In step 3 of the intervening representation, regression was carried out in assessing the association of Qualitative Characteristics with Internal Control Framework while ignoring Audit Committee Attribute and the results indicated the model as a whole insignificant. Findings further showed that the model regression coefficient of Internal Control Framework (β= 0.00325, p>0.05) was not statistically significant while R-squared (R^2) was 0.0084 which implied that Internal Control Framework accounted for 0.84% of the variation in FRQ. This further showed that Internal Control Framework was not a significant predictor variable and therefore, there was insignificant association amidst Internal Control Framework with FRQ.

In step 4, the mediation model, panel regression analysis assessed the interconnection between FRQ, Internal Control Framework and Audit Committee Independence. The outcome showed that the model as a whole was insignificant. Results further unveils the evidence that AC Independence (β= 0.0133, p>0.01) was a significant predicator of Financial Reporting Quality. Additionally, the results indicated the model regression coefficient of Internal Control Framework (β= 0.00341, p>0.05) was not statistically significant, as a result, Internal Control Framework had no significant influence on Financial Reporting Quality. R-squared (R^2) was 0.0358 implying that that Audit Committee Independence and Internal Control Framework jointly accounted for 3.58% of the variance in Financial Reporting Quality.

The study findings confirm that internal control had no intervening effect on association of AC attributes with FRQ of SOCEs. Findings showed inconsistency with the previous studies. For instance, Doyle and McVay (2007a) found that small firm with independent and qualified

audit committees which exhibited serious internal control weaknesses disclosed more internal control weakness thus improving financial reporting quality in these organizations. Further, McMullen and Raghunandan (1996) confirm that firms experiencing FR challenges did not have qualified audit committees members with accounting qualification. Further, Zhou et al. (2007) suggest that non-independent AC and with members with less financial and accounting expertise experienced internal control weakness and poor FRQ. This confirms the role strong internal controls plays in the stewardship and governance of SOCEs in Kenya.

CONCLUSION

Research results reveal that mediation effect of internal control framework on the association between audit committee attributes and financial reporting quality of the state-owned commercial enterprises in Kenya was not statistically significant. Results further indicate that revealed that the intervening effect of internal control framework on the relationship between audit committee attributes and accrual quality as well as qualitative characteristics of state-owned commercial enterprises was also not statistically significant. Researchers could build on the results of this study and conduct future research by considering other categories of state-owned entities to evaluate the intervening effect.

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