Journal DOI: 10.36713/epra1013|SJIF Impact Factor (2024): 8.431 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 11 | Issue: 3|March 2024 -Peer-Reviewed Journal

AUDIT COMMITTEE SIZE AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT
The shareholders and stakeholders expect the banks to yield good financial returns. However, performance of banks in Kenya has been declining leading to their collapse or receivership. The decline in performance may be due to weak oversight role including audit structure. This study therefore sought to establish the relationship between audit committee size and financial performance of commercial banks in Kenya. The study is significant to boards of various banks, bank management, Central Bank of Kenya, scholars and the government. The target population was 42 commercial banks operating in Kenya. The study adopted longitudinal research design covering a period of five years (2013 - 2017). The study used secondary data extracted from annual audited financial statements and reports of commercial banks. Regression analysis and multicollinearity tests were carried out using SPSS. The study found that audit committee size was has no statistical significant relationship with financial performance. The study therefore concludes that audit committee size is not related to financial performance of commercial banks in Kenya.
KEY WORDS: *Audit committee size, financial performance, Commercial banks, Kenya*

INTRODUCTION
The occurrence of risks in banks and mismanagement directly results in decrease in the financial performance of banks (Wanjohi and Ndambiri, 2017). To ensure stability in financial performance, banks need to deal with risks by identifying their various sources (Wanjohi and Ndambiri, 2017). This will require banks to have better information about the current and potential customers and their financial conditions. Banks may need to implement risk governance mechanisms to evaluate money flow and minimize risks that the money is facing (Alshatti, 2015). This mechanisms may include use of audit committees to play a close oversight on the risk exposure.

Improper management of risk may result in liquidity risk brought about by the indebtedness of the banks. Commercial banks may collapse if there is poor management of loans or reduction in the quality of the loans advanced to the creditors (Sufi and Qaisar, 2015). While the link between risk and financial performance is evident in literature, the relationship between audit committee size and financial performance is not clear owing to limited studies. The risk controls adoption by an institution depends on risk decision made at corporate level as per governance structures and mechanisms of different institutions.

Commercial banks can adopt risk management mechanisms such as audit committee. According to Kallamu (2015), good returns are attributed to the existence of risk committee in the organization. Audit committee does the role of ensuring effective financial reporting, effectiveness in the internal audit, integrity of the financial statements and providing oversight on external report from auditors. A study done by (Samoei and Rono, 2016) found a significant effect of audit committee size on performance of firms.

LITERATURE REVIEW
Audit committee refers to a committee appointed by the board of governance to provide independent oversight to the bank operations and ensure effective financial reporting, effectiveness in the internal audit and integrity of the financial statements (Equity Bank, 2017). The members of the audit committee are selected from the board members. The structure of the audit committee, however, may vary from one bank to another.

Samoei and Rono (2016) observed that the size of audit committee has a significant effect on the financial performance of financial firms listed in Nairobi Securities Exchange in Kenya contrary to performance of public listed companies in Malaysia (Sean, Chyi, Choo, Yi and Hong, 2016). This suggests that there may be cross-border disparity in results or results may not be generalized across different sectors. Al-Matari, Al-Swidi, Bt Fadzil and Al-Matari (2012) studied the relationship between governance characteristics; board of directors, audit committee characteristics and performance of Saudi Arabia listed companies. The study found a significant relationship between the audit committee size and the firm financial performance. This mirrored findings of Samoei and Rono (2016) suggesting a need to carry out a similar study in Kenya.

Berkman and Zuta (2017) found that in Israel, the larger the audit committee sizes, the higher the likelihood of negative effect occurring, contradicting Samoei and Rono (2016) on Kenyan firms. These results suggest that variability on the impact of audit committee size on financial performance of commercial banks may exist between developed and developing economies. Samoei and Rono (2016) further observed that the presence of audit committee with experience enhances monitoring and lead to good performance of the firms listed in Nairobi stock exchange, hence, a need to evaluate the financial performance of commercial banks in Kenya. Berkman and Zuta (2017) observed that the percentage of the audit committee with expertise in the financial concept is associated with the likelihood of negative events in the company.

According to Arfan and Nasir (2014), audit committee composed of non-executive directors has a statistical influence on performance of firms in Pakistan. This study by Arfan and Nasir (2014) was carried out in Pakistan based on panel data and longitudinal research design. Salehi (2017), observed a positive relationship between audit committee and financial performance and contradicts the findings of (Tarighi, 2018) which observed no significant association between audit committee size and financial performance. According Mohammad, Wasiuzzaman, Morsali and Zaini, (2018), audit committee size statistically explains the likelihood of financial performance. Appiah (2016), revealed that corporate insolvency is related to audit committee presence and size in firms based in the United Kingdom but failed to show the relationship between audit committee size and financial performance.

A study done by Aldamen, Duncan, Kelly, Namara and Nagel (2012) on audit committee characteristics and firm performance during the global financial crisis found that smaller audit committee is associated with high performance of firms. The study was done in Australia focussing on listed firms. It is not clear whether similar findings can be replicated for commercial banks in Kenya. There is need to conduct a study in Kenya with the focus being commercial banks regulated by Central Bank of Kenya. This study contradicts Omer and Zuta (2017), who did a study on impact of audit committee size and composition on the negative events in the life of a company. The study by Omer and Zuta (2017), found that large audit committee sizes is significantly positvely related to the occurrence of negative events in a company. The study was done in Israel a developed country while the study by Aldamen, Duncan, Kelly, Namara and Nagel (2012) was done in Australia. This may have contributed in the difference in the findings.

METHODOLOGY

The study employed longitudinal research design. This enabled the analysis and comparison of secondary data collected from the commercial banks for the study period (2013-2017). The secondary data was collected from the published audited financial statements and reports of the targeted commercial banks. The study targeted all the 42 active commercial banks regulated and licensed by the Central Bank of Kenya (CBK, Annual report and Financial Statements, 2017).

Sample Size and Sampling Procedures.

The research adopted a census sampling design in which all 42 commercial banks in Kenya participated in the study.

DATA COLLECTION INSTRUMENTS

Data was extracted from the annual published audited financial statements and reports of the commercial banks for a period of five years (2013-2017) using a data extraction form. Websites of all commercial banks was used to access individual audited consolidated financial reports of the financial years 2013, 2014, 2015, 2016 and 2017. From these audited financial annual reports, data on the various audit committee sizes and financial performance was then recorded on the data extraction forms.

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Validity
Financial risk experts from banks and financial institutions and academia validated the data extraction form. Pre-testing the data extraction assured its reliability.

Reliability
Commercial banks are guided by ISA (International Standards of Accounting) and IFRS (International Financial Reporting Standards) and this ensured reliability of the data extracted from the annual consolidated financial statements and reports.

RESULTS

To establish the relationship between audit committee size and financial performance of commercial banks in Kenya, data on the number of audit committee members for the years 2013 to 2017 were extracted and a regression analysis done. First analysis was done on the audit committee sizes in various banks that existed for the years under study. The results are presented in Table 1.

Table 1
Audit committee sizes for commercial banks (2013- 2017)

Tier	2017	2016	2015	2014	2013	Mean
I	5.13	5.25	4.67	4.57	3.83	4.69
II	5.22	4.67	4.43	5.22	4.38	4.78
III	3.88	4.40	3.83	4.25	4.10	4.09
Mean	**4.74**	**4.77**	**4.31**	**4.68**	**4.10**	**4.52**

Source: Researcher data

The results indicate that generally, there has been a continuous increase (4.52-4.74) in the size of audit committee from 2013 to 2017 respectively across all the bank tiers. This is a strategy adopted by commercial banks to reduce risks and improve their financial performance. Tier II commercial banks recorded a mean of 4.78 audit committee members and Tier III recorded a mean of 4.09. Regression analysis for audit committee size and financial performance of the various tiers of commercial banks was carried out and results presented in Table 2.

Table 2
Audit committee size and RoA as per tier

Tier	R	R^2	Adjusted R^2	P value
I	0.29	0.084	0.06	0.069
II	0.081	0.006	-0.014	0.578
III	0.119	0.014	0.003	0.269

Source: Research data

From Table 2, there exist a relationship between audit committee size and financial performance measured by RoA for Tier I with a coefficient of $R=0.29$ which is not significant because the p value is greater than 0.05, $p=0.069$. For Tier II, there is a positive relationship with a coefficient of $R=0.081$, however this relationship is not significant given that the p value is 0.578 which is greater than 0.05. In Tier III banks, there is a positive relationship between audit committee size and RoA with a coefficient of $R=0.119$, $p>0.05$. This indicates that even though there exist a positive relationship, the relationship is not significant. To establish the relationship that existed between audit committee size and financial performance of commercial banks, the research hypothesis that stated that there is no significant relationship between audit committee size and financial performance of commercial banks in Kenya was tested. The results are presented in Table 3.

Table 3
Regression analysis between audit committee size and RoA

	β	SEb	β	T	Coefficients
Constant	2.220	0.718	-	3.093	
Main effects					
Audit committee size	-0.008	0.154	-0.004	-0.050	
R					0.004
R Square					0.000
Adjusted R Square					-0.006
R Square Change					0.000
Model F Change					0.002
Model Summary df					1
Sig. F Change					0.960
Durbin Watson					0.813

Note: Dependent variable, Risk committee
*The significance levels *p<0.05; p**<0.01*
Source: Research data

The results revealed a positive non-significant relationship between audit committee size and return on assets (R=0.004*;* p=0.960) as shown in table 3. Hence, the study failed to reject the null hypothesis. Further analysis as per the tiers in table 2 showed that the relationship was still not significant in any of the Tiers. The unstandardized coefficients which represents the slope of the regression, β = -0.008 means that a unit change in audit committee size will change the RoA by -0.008 units and the constant β = 2.220 indicating that when the audit committee size is zero, the RoA will be 2.220 units.
The regression equation will therefore be: -

$$Y = 2.220 + -0.008_{AC} + \varepsilon$$

Where;
Y - Financial performance indicated by RoA
AC – Audit committee size
ε - Error term
This study confirms a study that was done by Omer and Zuta (2017), who did a study on impact of audit committee size and composition on the negative events in the life of a company. The study by Omer and Zuta (2017), found that large audit committee sizes is significantly positively related to the occurrence of negative events in a company. Eventhough the study was done in Israel, a developed country, the findings were similar to the findings of this study that was done in Kenya a developing country. The findings of this study contradict those of Samoei and Rono (2016) which found that audit committee size to have significant effect on financial performance. The study by Samoei and Rono (2016) used explanatory research design with the study area being listed companies while this study used longitudinal reaserch design to collect data from secondary sources of commercial banks and this may have caused the difference in the findings.

SUMMARY

On the relationship between audit committee size and financial performance, audit committee size was found to have no significant relationship with financial performance as measured by RoA. The results indicated regression coefficient (R=0.004, (p>0.05) meaning that the relationship was not statistically significant.

CONCLUSIONS

The study found no statistical significance between audit committee size and financial performance with coefficients. The study therefore concludes that audit committee size is not related to financial performance of commercial banks in Kenya.

RECOMMENDATION FOR FURTHER STUDY

The study also recommends that other studies should be done on other attributes of audit committees for example training and expertise of audit committee members. This is to establish if other attributes of audit committees have a relationship with the performance of commercial banks other than size. Also further research can be done using different research designs.

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