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Audit Committees and Public Financial Management in Coastal Counties of Kenya

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Abstract

The enactment of the 2010 Constitution in Kenya, implemented a decentralized form of governance to promote equitable development across both levels of government. This framework introduced mechanisms for equitable resource allocation between the national government and the 47 devolved units. However, the Controller of Budget (COB) reported persistent issues in financial management and misuse of public funds within these decentralized entities. This study investigated the function played by audit committees in enhancing management of public finances in coastal counties of Kenya, with specific focus on composition of audit committees. This research was grounded on Institutional theory. The study employed a descriptive research design with a targeted group of 144 individuals and 40 respondents. Standardized and self-administered questionnaires were employed to gather data. SPSS version 28 was employed for analysis of data. Inferential techniques and Descriptive statistics including Pearson correlation and regression analysis, were employed. Audit committee composition was found to affect public financial management positively, with diverse professional expertise enhancing decision-making. Gender diversity, though recognized, was less emphasized, pointing to the need for more inclusive representation. The study revealed that audit committees play a pivotal role in strengthening management of public finances by ensuring oversight autonomy. It recommended that County governments put in place measures to promote diversity in audit committee composition. County governments should ensure that audit committees include members with expertise in finance, accounting, risk management, and legal affairs.

Keywords: Audit Committee, Audit Committee Composition, Public Financial Management, Coastal Counties, Kenya

1. Introduction

1.1 Background

IFAC 2019 report stated that the 1MDB scandal in Malaysia, failures of Carillion, Patisserie Valerie, and London Capital & Finance in the UK, and the problems with Transnet, Eskom, and South African Airways have all shown that there are major problems with corporate governance. These problems have also drawn the attention of politicians and regulators to the audit profession. The report concluded that bad management and decisions, not poor reports, are what really cause businesses to fail.

The South Africa, King IV Code of Corporate Governance, states that audit committees are in charge of evaluating the organization's integrated assurance procedures on its own. These procedures include the finance department, internal audit, and external assurance service providers. It also suggests that the audit committees consider the effectiveness of the CFO.

In Kenya, circulars No. AG3/086/6 (61) of August 8, 2000, 16/2005 and 18/2005 have all focused-on setting up audit committee in the Kenyan public sector. The enactment of the PFM act 2012 necessitated issuance of Kenya Gazette notice number 2690 of 15thApril, 2016, to provide guidelines for national and county government entities on internal audit arrangements. The desire for establishment of county audit committees in Kenya is to ensure prudent use of resources at the disposal of the county governments and eliminate corruption and misuse of public resources. These efforts show the need to have functional and autonomous audit committees in the public sector in Kenya.

Researchers in Europe like Stapenhurst et al., 2019, Dassen, Ewelt-Knauer, & Klammer, 2019 and Galloux et al., 2018 have all focused-on audit committees' effectiveness in local governments particularly in addressing financial accountability and transparency, complexity of decentralized federal structure that poses challenges for standardizing audit committee practices across various regions and the role played by administrative regions in public finance management, need for coordination between central and regional audit committees respectively.

The need for fiscal transparency and accountability in local governments in Nigeria has been addressed by (Onyali & Abugu, 2020). The main challenge has been issues of capacity, autonomy and the need for a standardized approach to public financial management. In South Africa, a country with a sophisticated governance framework, challenges arise in balancing the autonomy of local governments with the need for centralized oversight by audit committees (Ndou, de Jager, & de Lange, 2019).

Kenya's devolved governance structure, faces challenges related to the coordination and standardization of audit committee practices across various counties (Buchi, Onsongo, & Yongo, 2020). The regional context highlights the need for mechanisms that promote consistency in financial oversight while recognizing the unique challenges faced by individual counties. Sharing best practices and establishing a framework for collaboration among audit committees in different Kenyan counties become essential for ensuring effective public financial management.

Within counties of Kenya, functioning of audit committees and their effect in safeguarding public finances varies, presenting distinct challenges and opportunities. In Nairobi County, the nation's capital and economic hub, the challenge of enhancing financial transparency and accountability through audit committees has been a focal point (Ondabu & Ndeda, 2020). The local scenario underscores the need for robust oversight mechanisms to address the unique financial complexities associated with high economic activity and ensure accountable management of public funds.

In Mombasa County, a region with significant economic diversity, challenges arise in aligning audit committee functions with the county's developmental priorities (Njeru et al., 2021). The local context emphasizes the importance of tailoring audit committee oversight to specific economic drivers, fostering a symbiotic relationship between county's development goals and best financial management practices. This requires a nuanced approach to public financial management that considers the unique economic landscape of each county.

Kisumu County, situated in western Kenya, faces distinct challenges related to the capacity and training of audit committee members (Ombuki-Berman & Okibo, 2021). The local scenario calls attention to the need of investing in the professional development of audit committee members to enhance their analytical skills and financial acumen. Strengthening the capabilities of audit committees becomes crucial for effective oversight in public financial management within counties, ensuring they are equipped to navigate complex financial landscapes.

In Wajir County, located in the arid northeastern region, issues of financial management are exacerbated by resource scarcity and limited revenue bases (Mohamed & Yussuf, 2018). The local context underscores the need for innovative financial strategies and the vital function of audit committees in ensuring efficient utilization of scarce resources. Tailoring oversight mechanisms to address the unique challenges faced by counties with limited economic resources becomes essential for effective public financial management.

Kakamega County in western Kenya, grapples with challenges related to internal control systems and financial reporting adequacy (Omache & Ndeda, 2021). The local scenario emphasizes the need of audit committees in strengthening internal controls and ensuring comprehensive financial reporting. Addressing these challenges at the county level is pivotal for audit committees to fulfill their role in overseeing public finances effectively.

1.2 Statement of the problem

In a worldwide setting, surveys on audit committees and county government public financial management have yielded important insights and findings. In the United Kingdom, Stapenhurst et al. (2019) did research which examined the efficacy of audit committees in local governments. The report brought attention to issues with financial transparency and accountability. The context's distinctiveness presents a constraint, since the UK's governance system could not be entirely reflective of other European nations. As a result, there is a research vacuum in our knowledge of how audit committees' function in various European contexts, calling for studies that include a wider variety of nations in order to produce more broadly applicable findings.

Dassen, Ewelt-Knauer, and Klammer (2019) studied internal audit and its function in German public sector governance in a regional context of Europe. The decentralized federal system was the main topic of the study, which also highlighted the difficulties in harmonizing audit committee procedures between geographic areas. The study offered insightful information about the intricacies of the German governing structure. The only emphasis on Germany, however, limits the study and leaves open the question of how audit committee processes differ in other European nations. Subsequent research endeavors ought to focus on examining various European settings in order to reveal local variations and trends.

Moving back to Africa, Onyali and Abugu's (2020) study assessed the efficiency of audit committees in Nigerian local government administration. Financial reporting quality was the main emphasis and results showed capacity and autonomy issues. But because the study only looked at Nigeria, there is a knowledge vacuum about the larger regional dynamics of Africa. To close the study gap and find common issues and best practices, a deeper comprehension of audit committee operations among the many African nations is required.

Ndou, de Jager, and de Lange (2019) reviewed the successes and difficulties of research on local government audit committees in South Africa. The study emphasized problems in striking a balance between local control and centralized monitoring. The findings are limited by their exclusive emphasis on South Africa, even if they offer valuable regional insights. Research across several African nations is necessary to close this gap by capturing the subtleties of audit committee functions under diverse governance frameworks.

Ondabu and Ndeda (2020) investigated financial reporting quality and the efficacy of audit committees in Nairobi County, Kenya. The study offered insightful information about issues pertaining to financial accountability and transparency. The study is limited by its exclusive emphasis on Nairobi County, and there is a research void about the functioning of audit committees in other Kenyan counties. Additional research ought to examine the differences in the governance frameworks and difficulties that audit committees encounter across various nations.

Omache and Ndeda (2021) evaluated the sufficiency of internal controls systems and financial reporting in Kakamega County. The study found difficulties unique to internal controls. The study's focus on Kakamega County, however, indicates a knowledge deficit on the operation of audit committees in other Kenyan counties. Further research including a wide variety of Kenyan counties is necessary to have a thorough knowledge of audit committee processes at the local level.

There are significant research gaps even though previous studies on audit committees and public financial management offer insightful information. These include; the dearth of thorough understanding of audit committee methods in Europe, regional differences within Africa, and the requirement for a more thorough investigation of audit committees in various Kenyan counties. Closing these gaps may help comprehend audit committees' functions in various local, regional, and international contexts more deeply.

The barriers faced by audit committees in public financial management within coastal counties of Kenya are discernible from reports of the Auditor General. Challenges such as inadequate financial transparency, lapses in accountability mechanisms, and deficiencies in the internal control systems within the coastal counties are highlighted in the reports. These barriers pose a threat to effectiveness of audit committees in providing assurance on public finance management, thus, hindering their ability to provide comprehensive and accurate financial reports. The coastal counties' economic diversity, influenced by factors such as tourism and trade, further complicates financial management, necessitating targeted strategies to improve the ability of audit committees in navigating these challenges. Addressing these barriers is imperative for strengthening the role played by audit committees in ensuring transparent and accountable public financial management within Kenya's coastal counties.

1.3 Objectives of the study

The study’s objective was to establish the correlation that exists between audit committees and public financial management in coastal counties of Kenya

2. Literature Review

2.1 Theoretical framework - Institutional Theory

Institutional theory is a common sociological perspective in organizational studies, that has been applied to analyze and comprehend the structures, operations, and effects of institutions. The theory asserts that, organizations adhere to dominant institutional practices, values and norms to ensure their sustainability and establish credibility within their respective environments. Meyer and Rowan, whose’ seminal 1977 paper introduced the concept of isomorphism, are prominent advocates of Institutional Theory (Meyer & Rowan, 1977).

Composition of audit committees is integral in corporate governance for ensuring financial reporting in organizations is both accurate and transparent. Numerous investigations have been carried out to explore the correlation between qualities of audit committees and their effect on public financial management. In an effort to enhance their credibility with stakeholders, organizations may structure their audit committees in alignment with institutional pressures and expectations, as posited by institutional theory (DiMaggio & Powell, 1983).

Scholars have conducted extensive research on Institutional Theory to find out how composition of audit committees impact management of public finances. As an illustration, the manner in which public sector organizations conform to institutional standards through the establishment of audit committees comprising a diverse range of expertise was examined by Jones and Pollitt (2005). In pursuit of establishing credibility and gaining public trust, businesses frequently imitate the organizational structures of their more successful rivals, according to the study (Jones & Pollitt, 2005).

Furthermore, research conducted by Brown and Caylor (2009) investigated the institutional influences that companies confront when determining the structure of their audit committees. In order to comply with legal obligations and external expectations, organizations functioning in regulated environments are more inclined to establish audit committees comprising a greater proportion of independent members.

Audit committee composition impact on quality and accountability in financial reporting within the domain of public financial management has been empirically established. Previous studies have found strengthened adherence to accounting standards and improved financial reporting procedures to be favorably connected with the financial literacy of members of audit committees (Klein, 2002).

Institutional Theory provides valuable lens to examine the manner in which organizations establish their audit committees in reaction to external pressures, motivated by the need for credibility. The body of research on the application of this theory to public financial management and audit committee composition demonstrates how adherence to institutional norms and expectations influences organizational behavior. As organizations navigate the complex landscape of public financial management in response to external institutional constraints, the composition of audit committees becomes apparent, thereby impacting the standard of financial reporting and overall accountability.

2.2 Empirical Literature

Ruto (2016) aimed to understand the connection between efficacy of audit committees and management of finances of Kenyan government ministries. Using a descriptive research strategy and a simple random sample procedure, primary data were collected. The primary purposes of the research were examining the audit committee's charter, composition, independence, and technical qualifications of its members. Data shows that audit committees with three or more members perform better than those with fewer, and that auditor competence in developing an approach that is rigorous and structured to assess and refine effectiveness of controls, governance and management of risk procedures is a key component in this efficiency. It is possible that other critical elements impacting the dynamics of financial management would go unnoticed because the study is overly focused on certain audit committee qualities. Future research might expand our understanding of audit committees' effects on financial management by testing their generalizability to different sectors and investigating their impact on additional audit committee characteristics.

Ogoro (2015) investigated how audit committees could work well to reduce the frequency of restatements in financial statements for Kenyan state-owned enterprises. The factors under consideration were tenure, number of directorships held, financial acumen, committee size, independence of directors, meeting frequency, and number of directorships. The study's aim was to establish if audit committees meet the legal requirements for their makeup and, if so, how these requirements impact the committees' efficiency. As a result of their statistically significant effects on reducing the number of restatements to financial statements, multiple directorships and tenure of audit committees were determined to be the most important and consequential audit committee features. A subset of audit committee characteristics was the focus of Ogoro's research. Unknown variables, such as communication styles or cultural peculiarities, can be examined. Additional research may seek to establish the relationships between these characteristics and restatements of financial accounts, even if the study identified important aspects.

Erick Kipkoech Kirui (2021) investigated how traits of audit committees influence audit efficacy in the county of Kericho. A census technique was used to select 68 senior personnel of the Kericho County Government to participate in the study. Findings revealed that impartiality of audit committee members and their financial expertise greatly improved audit effectiveness. The survey established that the tenure of audit committee significantly impacted audit effectiveness negatively, although meeting frequency had no substantial influence. It is unclear if the findings are generalizable to other domains or organizational structures due to the study' exclusive emphasis on Kericho County Government. Because this study only looked at one characteristic at a time, there may be some unanswered questions about how these factors interact with one another and how other factors influence audit effectiveness.

Three researchers Boateng, A., Mgbame, C. O., and Chijoke-Mgbame, A, investigated board gender diversity, audit committee composition, and profitability in 2020. The research relied on data collected in Nigeria. The study found that the bottom line of a company would greatly benefit in having more female board members. Findings indicated that when more women served on the audit committee, the company's financial performance increased. Concerning cultural influences on financial performance and gender diversity on boards, the study's sole focus on Nigeria is a limiting factor on the generalizability of the findings. Due to its narrow emphasis on gender diversity and the audit committee, the study fails to take into account the possible contributions of other board elements.

3. Research Methodology

This research utilized a descriptive research strategy. This refers to specific research questions, methods, and analysis that were employed. Gathering information on events, arranging, tabulating, illustrating, and summarizing it, are all part of descriptive research, as stated by Glass and Hopkins (1984). Descriptive research can either be qualitative or quantitative, according to a statement made by the Association of Educational Communications and Technology on August 3, 2001. Descriptive statistics explain the world as it is, whereas inferential statistics seek to prove cause and effect. The research aimed to deduce conclusions on audit committees' effectiveness.

The researcher employed triangulation technique to gather data. Methods such as surveys, document analysis, and first-hand observation were used in this research. Structured self-administered questionnaires were utilized to gather quantitative primary data. Questionnaire were sufficient for this study as they are commonly used to acquire crucial community data (Ghauri & Gronhaug, 2020). The purpose of each survey question was to further a predetermined

objective.
Upon acquiring the raw data, thorough verification of surveys was conducted to detect and rectify missing data or errors. The SPSS a specialized statistical tool, was utilized for data tabulation and coding. The researcher employed means, frequencies, and standard deviation for data analysis. For inferential statistics, regression analysis was utilized.
To ensure the absence of collinearity among predictor variables, a multicollinearity test was carried out. Multicollinearity refers to significant correlations among research predictors, as defined by Chris (2008). A Variance Inflation Factor (VIF) exceeding 10 was considered indicative of multicollinearity, as stated by Field (2013). The presence of multicollinearity reduced the reliability of multiple regression models, leading to increased coefficient error as collinearity levels rose.
The Graduate School of Kenyatta University and NACOSTI approvals were sought before undertaking the research. Ethical considerations in the study incorporated the privacy and confidentiality of respondents, informed consent, minimizing risk, voluntariness, data collection methods, and time taken. Work by other researchers were properly referenced and acknowledged.

4 Data Analysis and Presentation

This section gives a summary of descriptive statistics analyzed over the study pierid. The table below is a summary of the statistics.

4.1 Effect of Audit Committee Composition on Public Financial Management

Table 1: Descriptive Statistics on Effect of Audit Committee Composition on Public Financial Management

Statement	N	Mean	Std. Deviation
The audit committee consists of members with strong accounting and financial expertise.	40	4.20	0.950
The audit committee includes individuals with diverse professional backgrounds to enhance effectiveness.	40	4.05	1.003
The audit committee size is appropriate for effective deliberations.	40	3.95	1.015
The audit committee consists of an optimal number of members for efficient operations.	40	3.98	1.089
The audit committee is actively working towards achieving gender diversity.	40	3.85	1.167
Gender diversity is considered a priority in the selection and composition of the audit committee.	40	3.78	1.194

The findings suggest that respondents strongly agreed that a well-composed audit committee enhances public financial management. The presence of members with strong accounting expertise received the highest mean score (4.20), indicating its perceived importance in financial oversight. The study also found that professional diversity and gender diversity are valued aspects of committee composition, though gender diversity scored slightly lower than other factors.

4.2 Public Financial Management

Table 2: Descriptive Statistics on Public Financial Management

Statement	N	Mean	Std. Deviation
The audit committee decisions and activities are aligned with the overall financial goals of the coastal counties.	40	4.08	0.982
The audit committee actively contributes to formulation of finance strategies that support the development objectives of the coastal counties.	40	4.02	1.045
The audit committee ensures that financial reports are prepared and presented in a timely manner.	40	4.15	0.895
The audit committee is proactive in identifying and addressing potential risks to public financial management.	40	4.05	1.015
The committee's interventions lead to practical solutions for overcoming financial management obstacles.	40	3.98	1.098
Stakeholders perceive the audit committee as a key player in resolving financial difficulties.	40	4.00	1.062

The findings suggest that respondents largely agreed that public financial management is significantly influenced by the audit committee's role. The highest-rated statement was the timely preparation and presentation of financial reports (mean = 4.15), reinforcing the need for transparency and accountability in public finance. Proactive risk identification and intervention strategies also received high scores, underlining the importance of financial oversight in mitigating financial risks.

4.3 Correlation Analysis

Table 3: Pearson Correlation

		Public financial management	Audit committee composition
Public financial management	Pearson Correlation	1	
	Sig. (2- tailed)		
	N	40	
Audit committee composition	Pearson Correlation	.741**	1
	Sig. (2- tailed)	.000	
	N	40	40

**. Correlation is significant at the 0.01 level (2-tailed).

The outcome showed a positive correlation between the dependent variable (public financial management) and the independent variable audit committee composition. According to the analysis, the association coefficients for audit committee composition was 0.741. This suggests a positive correlation between public financial management, and audit committee composition.

4.4 Regression Analysis

Coefficient of Determination (R^2)

The research model was assessed by a confirmatory factors analysis. to assess the model's effectiveness and forecast the causal relationship between the independent variables and the dependent variable, linear regression analysis was performed on the four factors.

Table 4: Coefficient of Determination (R2)

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.904[a]	.817	.809	1.06178
a. Predictors: (Constant), Audit committee Composition				

The model accounts for 81.7% of the variation in public financial management (Adjusted R Square = 0.809). It is obvious that public financial management can be predicted by criteria other than the one suggested in this model. This indicates that 81.7% of the relationship is explained by audit committee independence, while other factors of public financial management not examined in this study account for 18.3%.

Analysis of Variance (ANOVA)

The relevance of the regression model was assessed by use of ANOVA. In determining the significance threshold, a p-value of less than or equal to 0.05 was considered significant. This indicates that the regression model's ability to predict factors of public financial management is statistically significant. This signifies reliability of the data with a 95% confidence level. This model was significant according to the total ANOVA results, with F= 105.833 and P= 0.000

Table 5: ANOVA

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	477.258	3	119.315	105.833	.000[b]
	Residual	107.102	36	1.127		
	Total	584.360	39			
a. Dependent Variable: Public financial management						
b. Predictors: Audit committee composition						

Multiple Regression

Table 6: Multiple Regression

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.464	1.306		3.194	.001
	Audit committee composition	.914	.098	.809	9.275	.000
a. Dependent Variable: public financial management						

The regression equation above has established that taking all factors into account (public financial management as a result of Audit composition) constant at zero public financial management was 1.464. The results demonstrated that, when the independent variables were set to zero, public financial management scores increased by 0.914 for every unit increase in audit committee composition.

5 Summary, Conclusions, And Recommendations

5.1 Summary of Findings

Public financial management was found to be significantly impacted by the audit committee make-up. Respondents emphasized that having committee members with strong accounting and financial expertise contributes to effective decision-making, better risk assessment, and improved financial oversight. The presence of professionals from diverse backgrounds was also found to enhance the committee's ability to analyze financial issues from multiple perspectives, leading to more informed financial decisions.

Additionally, the study indicated that gender diversity within audit committees is increasingly being considered an important factor in improving governance and transparency. However, gender diversity scored slightly lower compared to other factors, indicating that while diversity is valued, more efforts are needed to promote balanced representation in audit committees. These results are consistent with the study by Abbott et al. (2021), which emphasized that diverse audit committees bring different perspectives that strengthen financial oversight, ultimately improving public sector financial management.

5.2 Conclusions

The results of the study support a notion that audit committee are essential in strengthening public financial management. Audit committee composition is a key determinant of financial oversight effectiveness. Committees with professionals who have expertise in accounting, auditing, and financial management are better equipped to identify financial risks, analyze financial reports, and provide strategic recommendations. Furthermore, diversity in audit committees, particularly in terms of gender and professional background, enhances governance and improves decision-making processes

This research has demonstrated that audit committees are a fundamental component of public financial management. The composition of the audit committee significantly enhances financial oversight, accountability, and compliance in public institutions. Strengthening audit committees through policy reforms, capacity-building initiatives, and technology integration ensures that counties manage public funds effectively and uphold financial integrity.

5.3 Recommendations

County governments should put in place measures to promote diversity in audit committee composition. County governments should ensure that audit committees include members with expertise in finance, accounting, risk management, and legal affairs. Moreover, gender balance in audit committees should be encouraged to enhance governance and ethical decision-making.

Declaration of Competing Interests

The authors declare that they are not aware of any competing financial interests or personal relationships that may have influenced the work described in this document.

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Ethical considerations

The article followed all ethical standards appropriate for this kind of research.

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