

**EFFECTS OF AUDIT ROTATION ON AUDITOR INDEPENDENCE AND
QUALITY OF AUDIT SERVICES IN KENYAN COMMERCIAL BANKS**

BY

SOPHIE WAMBUI MAINA

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DECLARATION

This project is my original work and has not been presented for assessment or academic award to any other university or institution of higher learning.

Signature 

Date ...5-5-2022

Sophie Wambui Maina

D61/20621/2019

This project has been submitted for examination with my approval as the University Supervisor.

Signature.....

Date 1st NOV 2021

Mr. James M. Nganga

Lecturer; Department of Finance and Accounting

School of Business, University of Nairobi

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Auditing is a systematic and objective approach of obtaining financial information for the reason of assessing and evaluating evidence to establish whether they conform to the set organization procedures and objectives and communicate the obtained results to interested parties or users (Kanter, 2010). For effective delivery of the auditing services to an organization, Dao et al., (2008) recommends auditor rotation. In fact, Mohamed & Habib (2020) further claim that practising auditor rotation is to a larger extent cost effect method of enhancing auditor independence between the client and the auditor.

In most cases, the beneficiaries of the audit service evaluate the auditor's independence through the lens of financial reports of the client's business firms, which should impartially reveal the financial discrepancies as well as the projected risks. Nonetheless, there has been a presumption that the independence of the audit firm may be adversely compromised when there is excessive social ties or relationships between the auditors and the audited (Gates et al., 2007; Dao et al., 2008; Arel et al., 2005). Therefore, in effort to gain public trust and increase audit quality as well as auditor independence, there have been advancement of associated regulations as well as codes of conduct. Some of the changes in regulations are rotation of auditors (Firth, Rui & Wu, 2010; Gates, Lowe & Reckers, 2007).

Practising auditors' rotation according to Carcello, & Nagy (2004) not only bring cost reduction but also guarantee various other benefits such as enhanced credibility, reliability and independence of the auditors and this are the premise for the justification of the need to practice audit rotation by firms (Pany, 2015). Previously, auditors' reputations and character have been adversely damaged by many accounting scandals. For instance, it commenced with the fall of one of the globe's highly reputable audit organization, Arthur Andersen as a result of the Enron

scandal that took place in 2002. This gave rise to the castigation of the credibility of the audited financial statements. Besides, quality of audit services and auditor independence were as well questioned by various stakeholders (Firth, Wu & Rui, 2010; Chaney & Philipich, 2002). Therefore, perfection of auditor independence and quality of auditor services is a great concern for most of the business firms seeking auditing services as this will also go a long way in restoring reputation of the audit firms. Independence forms one of the indispensable attitudes required from auditors when delivering their service (Corbela *et al.*, 2015).

It is also prudent to mention that audit rotation guidelines and regulations differ with countries across the globe and also vary with the form of rotation and duration of time frame (Firth, Rui & Wu, 2010; Rong, 2017). The methodology of lessening the years of engaging the services of an auditor is aimed at ensuring that there is increased efficiency in auditing processes and improved quality of audit services (Rong, 2017). According to the recommendations of Sarbanes-Oxley Act (2002), there should be a five-year rotation of lead audit partner and the audit review partner for any public organization. The practice of rotation of audit firm is witnessed in some states across Europe such as Spain, Italy and Israel (Catanach & Walker, 2019).

In fact, EU officially accepted to implement the law of mandatory audit rotation of the firm in 2014. The law regulates that auditors should be changed every ten years upon engagement by any public firm or organization. This is because it is assumed that longer or lengthy audit tenure compromises the independence of auditors, given that when auditor stays longer in an organization they tend to become more familiar and friendly with the client (Rong, 2017). When the client and the auditor become over friendly and familiar, there will be less or careless assessment and detection risks as a result of too much confident in undertaking the audit procedures. Therefore, the probability of the auditor giving out a prejudiced opinion will be

high (Sayyar *et al.*, 2014). Hence, changing regularly the auditors through well-structured rotational auditors seems hopeful in addressing this issue.

Although there are many positive attributes associated with auditor rotation especially when it comes to enhancing auditor independence, the practice is also attracting negative arguments against it. For instance, based on the audit tenure, it is believed that the more an auditor stays in an organization, the deeper he or she understands the business dynamics of the client and thereby give a quality output in terms of audit services (Carcello & Nagy, 2014; Myers, Myers, & Omer, 2013). Therefore, it is argued that practising auditor rotation will result into loss of such knowledge, thereby compromising the quality of audit services (Williams & Wilder, 2017). It against these inconsistencies on the conclusion of how auditor rotation influence the quality of audit services that the present study sought to assess and address the ambiguity by studying the effects of audit rotation on auditor independence and quality of audit services in Kenyan commercial banks.

1.1.1 Audit Rotation

As described by Onwuchekwa *et al.*, (2016), audit rotation practices expects that there is a particular limit of time that the auditor or the audit firm is permitted to offer their services to the client or firm, thereby switching or changing them to guarantee independence of the auditor and quality of audit services. Besides, switching of auditors will help in solving the problem of favouritism, friendship and over-familiarization between the auditor and the client, which in many cases compromise independence of the auditor.

The auditor rotation was initially introduced in 1976 and the practice was can be categorised as either voluntary or mandatory. According to Lu, (2015) mandatory audit rotation forces the audited organization to bring fresh new auditors or engage a new audit firm after a certain duration of time, while voluntary rotation is an optional practice. In fact, practising mandatory

rotation among the commercial financial firms could either be through rotation of the audit organizations, in which the registered commercial banks in Kenya are required to either rotate their auditors or audit firms after some times of engagement for a period of about five years or rotate or change their audit-partners instead, in which commercial banks are required to change their lead audit partners who is charged with the responsibility of making audit decisions after a particular duration of time (Orin, 2008). Conversely, voluntary rotation approach is majorly dependant on decisions of bank management and their choices irrespective of time (Orin, 2008; Davidson et al., 2005).

1.1.2 Auditor Independence

Auditor independence is a very significant element when striving to enhance quality of audit services and upholding reliable financial reports or statements (EC, 2010). DeAngelo (1981) defines auditor independence as the impartial decision making by the auditor to the extent that he or she can report any breach or financial misstatements without favouritism. Presently, IFAC (2016) expects auditors to be impartial and independent when making decisions on their in both fact and appearance.

In fact, independence expects auditors to operate objectively and with integrity and not to yield or succumb to any pressure that would influence in a bad way, their professionalism when making financial judgement (IFAC 2016). Although it is not easy to quantify independence given that it is composed of various immeasurable elements such as behaviour several empirical studies have been conducted on audit tenures and rotation expectations as a determinant of auditor independence. For instance, Summer (2018) investigated a study on various types of auditors, assessing how they follow pressure or requests to give out favourable or prejudice statements for their clients. The study concluded that auditor rotation was effective in enhancing auditor independence and ultimately enhancing quality of audit services.

Similarly, Wang and Tuttle (2009) argued that, in financial institutions such as commercial banks, auditor independence is greatly enhanced through mandatory or forceful rotation of audit firms, thereby limiting the engagement, negotiation and favouritism between auditor and the audited commercial banks and ultimately, the outcome will be more favourable for the auditor or the audit firm than it will be to the client. Dopuch et al. (2011) also in their study concluded that auditor independence when engaged by the commercial banks would likely to be achieved when the banks carry out or implement proper mandatory audit rotation. In fact, according to Arel, Brody & Pany (2016) commercial banks that practice or adopt mandatory audit rotation are likely to work according to the allowed accounting guidelines for good quality outcome and performance.

1.1.3 Quality of Audit Services

DeAngelo (1981) explains that quality of audit services are assessed through two indicators namely the level of auditor independence and auditor competency. Given that the audit quality indicates the likelihood of auditors recognising and reporting a mistake, these indicators are much required to enable auditors enhance quality of audit services (Peecher & Piercey, 2008). By definition, auditor competence implies that the auditor is knowledgeable enough to handle a client unique business and that the auditor has also immense training and qualifications.

On the other hand, auditor independence implies that an auditor makes impartial decisions and judgment when carrying out audit procedures for the client. In fact, Lee et al., (2019) explains that audit quality depends largely on the auditor professionalism that also subscribes to the principles of auditor independence. When an auditor do not practice independence judgment and reporting, there is a likeliness that the audit quality will be compromised characterised by failure to detect risk and misstatements. Moreover, auditors must show high degree of honesty

and neutrality, without taking any side as this will increase public confidence on whatever decision or report they give.

Other than honesty and impartiality in judgment, decision making and reporting, an auditor should possess sufficient technical knowledge with suitable education background as all these attributes significantly play an integral role in enhancing quality of audit services.

On the other hand, Peecher & Piercey (2008) states that measuring or assessing the quality of audit services differs hence making it difficult to precisely measure and come up with a single measurement criterion for audit quality. According to Peecher & Piercey, measurement of audit quality is done under two categories which are, out-put based proxies and input based proxies of quality of audit services. The output-based audit quality assessment is the material statements and monetary reporting elements, while the input-based audit quality measurement revolves around auditor-particular features as well as details of the auditing fee (Francis & Michas, 2012). In input-based proxy, auditors' characteristics are commonly assessed or measured via how big the auditing firm is, which is classified normally into either big N or non-big N audit firms. The Big N firms is presumed to be having the capacity to deliver good quality of audit practices as compared to non N audit firms (Hoitash et al., 2007).

Another input-based audit quality indicator is the auditing fee, which indicates the level of effort and appreciation of the auditor when assessing client's financial report. Audit fee relates with quality of audit services in the sense that high audit fee symbolises higher efforts and motivations in detecting risks in the financial statements, thereby generating high probability of delivering better audit quality. On the other hand, output-based assessment of audit quality that deals with material statement, actually provides a good representation of audit quality given that it directly reveal the auditing procedure that is used. Another way of measuring audit quality is fiscal reporting characteristics in which quality measurement is mainly done through

computation of the discretionary accruals. However, this approach is sometimes a weak and vulnerable one because it has measurement errors and favouritism as a result of strong connection between financial reporting elements and quality of audit services (Ball et al., 2012). In the present study, going concern approach will be adopted to measure the quality of audit services of the commercial banks as a result of audit rotation. Going concern opinions of the auditors has a vital role in creating awareness for the shareholders on the financial distress facing the audited firms and the probability of bankruptcy (Sormunen *et al.*, 2013). Therefore, based on the concept of going-concern, audit quality symbolises the actual integrity of the auditor as they give out their opinions explicitly to disclose financial condition of the firm without any favouritism or pleasing the client.

1.1.4 Audit Rotation and Auditors Independence

Practising auditor rotation can have an influence on auditor independence, integrity, honesty and professionalism. This is because, in cases whether the auditor or audit firm has overstayed with the client, (longer auditor tenure), the two parties tend to grow a lasting cordial and friendly relationship, whereby the auditor may now be too used to the organization's business management, the existing operation system to the extent that the auditor sacrifices his or her professionalism, objective opinions and independence just to please the client.

A positive influence of auditor rotation on independence is witnessed on the enhanced professionalism because the auditor will not be too close with management (Tepalagul & Lin, 2015). Moreover, longer auditor tenure would result in weakening the auditor independence. This is because when the auditor has over stayed with the client, he or she may build a tight and friendly association with the client, hence making judgments that are in favour of the management, thereby compromising objectivity and quality of audit services (Tepalagul & Lin, 2015). For instance, in a study conducted in Bocconi in Italy, it was found that since the

approval of mandatory audit rotation since 1974, majority of the managers of the listed firms confirmed the increased auditor independence and improved quality of audit services. It was also found that auditors that have overstayed were likely to concentrate on routine audit procedures, with little attention on suggesting for the firms' areas of improvements (European Commission, 2011).

Personal close ties with the client or management of the company may be very detrimental especially when it is required for the auditor to be objective and neutral in his reporting and opinions when undertaking audit procedures. Hence, these kind of relationships or ties ought to be broken to guarantee auditor independence. According to Davis et al. (2010), mandatory audit rotation practices positively influence audit quality in the sense that it enhances auditor independence that makes him make financial judgments and opinions without favouring the client. In fact, the longer the audit tenure with the same client, the less likely the auditor will detect material misstatement, as the auditor will be so much used to the audit procedures to the extent of overlooking new happenings in the business.

Similarly, Catanach and Walker (2019) while reviewing various globally raised issues on audit rotation mention that the promoters of mandatory rotation view the practice as a way of providing solutions to the problems that arise when auditor develops long relationships with the client, that may be harmful to the auditor independence and subsequently quality of audit services. Also, when Ewelt-Knauer, Gold & Pott (2013) reviewed various opinions of the stakeholders on mandatory audit rotation, they concluded that longer audit tenure is a threat to independence of an auditor and professional scepticism, which would the harm audit quality due to familiarity that exist between clients and auditors. Therefore, there is a conviction that regulating the tenure an auditor spend with the commercial banks will influence the quality of audit services as it eliminates the threats associated with compromised independence of the auditor.

1.1.5 Audit Rotation and Quality of Audit Services

The promoters of auditor rotations explain that the practice helps in revealing more financial information on the audited company (Davis et al., 2009) given that auditing practice is highly hinged on professionalism and that the lasting attachment between the auditor and the audited firm may lessen impartiality of the auditor judgment (Nagy, 2005; Wolf et al., 1999). Moreover, rotation practice assists in promoting competition among the auditors in the market, hence small auditing firms (none-Big Four) are encouraged to develop and cut their niche specialization given that rotation places all audit organizations on similar level and provides them with equal chances (Raiborn et al., 2006).

Both the auditor and the client may suffer huge losses whenever there is an audit failure that would have otherwise been thwarted when the client rotates its auditor or firm in which the practice comes with less cost compared to that which would have been incurred in trying to rectify audit failure through litigation processes (Jackson et al., 2008). However, those opposing the practice of auditor rotation insist that the approach has no value since they would use the litigation approach to force auditor to preserve the reputation of their companies (Davis et al., 2019).

Moreover, the opponents of audit rotation argue that it raises the cost of both changing the auditors and also the start-up cost, which may be felt by both the auditor and the client, which could have otherwise been saved with existing parties. Consequently, in the process of learning the business of the new client (learning curve cost), the auditor fees may be increased (Johnson et al., 2012). Lastly, they argue that auditors usually interact with the client almost on a daily basis during the audit procedure, hence, the two parties will always be familiar and friendly to each other irrespective of the audit tenure (Arel et al., 2015).

Inference can therefore be made that major discourse arising from the practice of auditor rotation among the commercial banks is whether the practice would improve or weakens the quality of audit services. The promoters of auditor rotation view the practice addresses amicably the problem associated with audit tenure, which they see as very harmful to the quality of audit services, whereby longer auditor tenure decreases the independence of the auditor, making him to be more lax when giving out a company's financial reporting (Lu, 2015).

1.1.6 Commercial Banks in Kenya

Kenyan banking sector operates within the confines of Companies Act (2015), the Central Bank of Kenya Act (1984), the Banking Act (1991) and different guidelines designed by the Central Bank of Kenya (CBK). Commercial Banks are institutions deals with financial deposits, provide loan facilities and many other associated financial services. These financial organizations similarly permit various account activities to be carried out such as account deposits and account savings. Generally, the main mission for commercial banks is to generate profits for their shareholders. The CBK main mandate for the banks is to license, supervise, and regulate in accordance to Banking Act (Cytonn, 2016).

However, according to Revised Banking Act Cap 488, the act does not get concerned with the issues to do with levying audit fees, although in circumstance where the bank fails to engage an auditor, then the CBK will go ahead and arrange for one and fixed the fees to be levied and that the charged fees will be taken care of by the bank. Similarly, the Act does not provide any specifications on audit firm tenure but give directions on the audit partner rotation, where by it sets a 5-year term limit for an audit partner and also manages the general audit of a bank that is to be rotated. However, recently, the CBK came up with a proposal that cap the bank auditors' tenure to not exceeding three years. Similarly, the ICPAK and CMA during their consultation, came into agreement to design guidelines that limit the years that an auditor should work for a given organization.

Based on growth, the Kenyan banking sector has witnessed tremendous growth and expansion in terms of assets, amount of deposits, level of profit making and various products offered (Otieno, 2012). This growth rate has mainly been influenced by various strategic approaches, good financial practices and sound auditing methodologies (Banking Chapter Report, 2016).

1.2 Research Problem

Audit rotation practices expects that there is a particular limit of time that the auditor or the audit firm is permitted to offer their services to the client or firm, thereby switching or changing them to guarantee independence of the auditor and quality of audit services. Besides, switching of auditors will help in solving the problem of favouritism, friendship and over-familiarization between the client and auditor, which in many cases compromises the auditors' independence. However, business organizations have a strong attachment to their auditors, which contributes to the low quality of audits. The independence of auditors is critical in the firm's pursuit of the highest quality audits in the auditing profession (Nichols and Price, 1976). It arises when auditors are unable to submit any misstatements discovered during the auditing of financial records. This is a big factor to the likelihood of a rise in disinformation among the many stakeholders involved (Kim, 2007). Long-term, this has the consequence of increasing the levels of poor communication between management and shareholders. When this happens, GAAP reporting techniques are less likely to issue our ongoing concerns (Kim et al., 2007).

For commercial banks in Kenya, the Capital Markets Authority has been advocating for a change in audit firms, not auditors. The Banking Act requires audit partner rotation rather than audit firm rotation. Quality of audit services of commercial banks tends to deteriorate due to auditors' lack of independence, which is largely linked to the auditors' long-term attachment to them and this prevents them from recognizing and disclosing misstatements that may occur in the banks's financial records (Kim, 2007).

Mohaisen, Ali & Albadri, (2019) assessed the nature of relationship that existed between audit rotation as practised in both level of partner or firm and the quality of auditing services in Iraq. The findings uncovered a significant and positive correlation between voluntary audit rotation and the total discretionary accruals value implying that voluntary audit firm rotation significantly and negatively correlate with audit quality. Similarly, Mohamed & Habib (2020) studied Audit Rotation and its effect on Quality and Independence in Egypt and ascertained that audit rotation results in auditors' independence and subsequently enhanced quality of auditing services in various firms. Masika, (2019) also conducted a study to assess the manner in which threat-based auditing quality influenced the efficiency of state corporations in Kenya and found a positive relationship between the quality of internal auditing and efficiency of state owned corporations. The Audit rotation represented independent variable while audit quality was the dependent variable. Leposo, (2019) similarly carried out a study on auditor rotation and its influence on audit quality of Commercial banks and revealed a significant correlation between auditor rotation and quality of audit services given that the study recorded an overall statistical significance of 0.000. However, most of these past studies have used different methodologies, focusing on different business organizations, hence there is contextual gaps and so, no conclusive findings can be made on how audit rotation affect the auditors' independence and quality of audit services in commercial banks in Kenya. Consequently, the present study seeks to answer the question of what effect does auditor rotation have on auditor independence and quality of audit services of Kenyan commercial banks?

1.3 Objective of the Study

To assess how audit rotation affect or influence auditor independence and quality of audit services in Kenyan commercial banks

1.4 Value of the Study

Auditing practice has been witnessing intense pressure as a result of growing public expectations. The study findings will also be of immense help to different regulatory bodies such as ICPAK, CBK and CMA in that it will help these bodies in making candid policies on audit rotation that will be helpful for both the audit firms and the commercial financial institutions.

Besides, the study findings will assist in demystifying the real dynamics that deter achievement of quality auditing services in the country and offer a long term suggestions and probable solutions to those challenges that have effects auditor independence and quality of auditing services. The research also tries to find clarity into matters to do with audit quality to both the policy makers and the regulators to enable them come up with policies and guidelines that take care of the interests of shareholders. The present empirical study is assessing the effects of audit rotation on auditor independence and quality of audit services will therefore add to the existing body of literature.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section provides previous literature done both theoretically and empirically to establish the nature of association between audit rotation on auditor independence and quality of audit services in Kenyan commercial banks. The section also highlights different theories and their relevance to the present study.

2.2 Theoretical Review

The theory can be described as the premise on which the entire research is founded. This study will be guided by agency theory, The Assurance Theory and policeman theory. Hence, a theoretical model describes crucial attributes that are vital to the research questions and subsequently demonstrate the relationships between these variables.

2.2.1 Agency Theory

The Agency theory was modeled by Jensen and Meckling in 1976 and is likely to be the most significant theory that explains governance for both public and private institutions. The concept of agency can be explained by a circumstance in which a principal delegates an agent to carry out services on his or her behalf delegating decision-making power to the agent. The tenets of agency theory are based on the fact that individuals charged with the responsibility of representing others should eventually obligate corporate resources to realize optimal performance of the corporate organization they represent. These agents are required to be diligent and cautious when making corporate decisions to ensure that the principal's interests are taken care of.

An agency challenge can emanate from the nature of the relationship that exist between the agent and the principal in which a conflict of interest between the two arise. For instance, the agent can come up with decisions and policies favoring him or her without taking care of the interest of the principal, similarly, an agent can act in such a way that they promote their own interest which may be at the same time harmful to the principal resulting to moral hazard. Another problem can also arise when the agent has privy to more information than the principals hence creating mistrust and doubt between the two parties.

However, the critics of this theory have always claimed that the control approaches suggested on the premise of the theory other than being costly are also economically unproductive, given that contrivances guarding the interest of the shareholders may interfere with achievement of the organization objectives as well as restricting collective actions. Moreover, the weaknesses of agency theory in explaining corporate governance approaches, Van Essen (2011) assessed the functions of the ownership in various contexts by considering different formal and informal institutional arrangements in those contexts. Van Essen established that those who owns the organizations matter for the organizations' objectives as well as their performance; i.e., a crucial factor based on the ownership arrangements, organization strategy and performance correlations, is owner identity.

The theory is applicable to the present study from the perspective that while working for the principals, auditors assess the financial reports and deliver an unprejudiced view of the firm, giving the opinions and judgments within the principles of professionalism. Moreover, audited financial statements of the commercial banks enables the bank management answerable to shareholders (principals). In this case, the banks engage auditor as agents who are then expected to remain independent in their judgment and opinion for quality audit services.

2.2.2 Assurance Theory

Assurance service can be described as a service where an accountant makes conclusions on the reliability of a statement made by another party (Cosserat, 2009). Also, Elder et al. (2010) describes an assurance service as an autonomous professional service which enhance the quality of information made for policy or decision makers. Individuals charged with the responsibility of making business choices often seek for assurance services to assist them with improving the reliability and relevancy of the report or information made that would inform their decisions and policies.

According to Elder et al. (2010), one of the main approaches of assurance services as delivered by the auditors is through offering attestation services. When carrying out a attestation service, the auditor is expected to issue a report on the reliability and quality of the statement or report as utilised by another party. There are five main classes of attestation services namely audit of historical financial reports, audit of internal control over financial reporting, review of historical financial reports, attestation services on IT, and any other attestation service that may be applicable to a wide range of subject matters.

In the present study, this theory provides an insight on the role of auditor in providing the attestation services to commercial banks, where by these services are expected to be reliable and quality. However, the achievement of these features in a report may be influenced greatly when the clients (commercial banks) practice certain approaches such as auditor rotation.

2.2.3 Policeman Theory

Two scholars namely, Dowler and Harris in 1912 and Walton et al., in 1916 proposed this theory. The two drew their view from the tenets of Individualistic theory, which was postulated by Immanuel Kant and Herbert Spencer. According to Policeman Theory the main responsibility of an auditor is to search, discover and prevent fraudulent activities in a

company. This was the main focus initially in the early 20th century, however, with dynamic nature of business, auditors have shifted their focus providing reasonable assurance and authenticate the fact of the financial reports or statements they work on (Hayes et al., 2005).

Its relevance to the current study is that it underscores the responsibility of the auditors and the expectations the client expects from them. However, the detection role of the auditors may be harmed if their independence is compromised to the extent that the auditor makes prejudice judgment that favours the client. In addressing these gaps, most of the commercial banks have resort to practising auditor rotation and through this, the changing of the auditors may enhance auditor independent and subsequently quality of audit services. Therefore, the cardinal role of fraud detection and prevention lies with the commercial bank management who would then engage the services of an auditor that is impartial and independent, to detect material misstatements, offer suggestions and make judgements.

2.3 Determinants of Auditor Independence and Quality of Auditing Services

Measurement of auditor independence and auditing quality has for the past few years become one of the weighty topics in the field of auditing. However, the quality of auditing services as well as the independence of the auditors may be affected by various factors as highlighted below.

2.3.1 Audit Team Characteristics

Wooten, (2003) explains that audit team characteristics are the attributes clearly exhibited by the audit professionals of an audit firm. These characteristics are serious predictors of auditor independence and quality of audit services. An organization that engage the services of auditors in the correct approach would always attract worthy audit team that possess exemplary attributes. Further, Agunda, (2014) explains that for any professional auditor to

detect financial misstatements in audited organization, the said audit team must as well possess integrity at individual level. This is because, the team is composed of personnel that has more degree of professionalism and hence is high likely to perform their roles in auditing properly without missing any auditing step. Moreover, any audit staff who upholds high levels of professionalism and integrity is less likely to use insufficient evidence for their judgment (Agunda, 2014).

Therefore, in general, an audited firm that also have good implementation of a strict internal control processes, will likely engage a quality audit team that possesses high degree of integrity, whose output will also influence the quality of audit services (Wooten, 2003). Firth, Rui, & Wu, (2010) also explains that audit team with high integrity are less likely to be compromised, are highly independent in judgment and are more likely to detect material misstatements without any iota of bias (Wooten, 2003).

2.3.2 Factors Related to Reporting

The capacity to appropriately detect and report a material misstatement highly relies on the auditor independence (Bobbie & Booker 2016). In scenarios where auditor succumb to emotional, personal or financial manipulation or pressure, then of the auditor independence is compromised and there is high chances of compromising as well the quality of the audit services. Therefore, this correlates with the auditor independence where audit firms are capable of pointing out any element of material misstatement. Moreover, Wooten, (2003) explains that detecting financial or material misstatements is largely hindered by certain factors such as audit tenure, independence, pricing, just to mention but a few. In many cases, auditors may experience challenges related to pressure to shun him or her from reporting certain financial deficiencies in order to secure future audit fees.

According to Dao, Mishra, & Raghunandan, (2008) audit tenure, pricing, and provision of other audit services are hypothesised to influence not only auditor independence, but also capacity of the audit team to detect or recognise financial misstatements. To prevent losing future audit fees and hence eventual profitability on a client, auditors may experience pressure not to report certain accounting deficits. In fact, it is more convenient for a client to replace auditors than for the auditor to craft new business; hence, the auditor may be persuaded to do everything it takes to maintain the client.

2.3.3 Extra or additional Services

In auditing practice, pricing is highly influenced by the amount of services provided by the audit firm. When an auditor receives of large amount of payment that are not associated with the auditing practice, he or she may tend to compromise the level of independence as a result of high degree of bondage financially, because he or she feels he owes the audited organizations (Onwuchekwa, Erah, & Izedonmi, 2012). Additional or extra services when given to the auditors has been verified to have a relationship with quality audit services, (Wooten, 2003). This is because giving extra or additional services to auditors may affect pricing. There is high probability that when an auditing firm gives both consultancy services and auditing, some kind of fee savings is provided to the client. The auditing firm may compromise its independence if it is economically tied to the client after receiving large amount of fees unconnected to the auditing services. Furthermore, the auditor him or herself may be placed in a position of carrying out the audit to its own work especially if the given additional services are relating to sustaining the accounting tasks (Wooten 2003). Nonetheless auditors actually have claimed that there's a direct and positive correlation between quality of audit services and provisions of additional services. They claim that giving additional or extra audit services permits them to obtain a better comprehension of the client and its business processes.

2.4 Empirical Literature Review

Mohaisen, Ali & Albadri, (2019) assessed the nature of relationship that existed between audit rotation as practised in both level of partner or firm and the quality of auditing services in Iraq. The study also analysed the correlation between audit tenure and audit quality among the business firms in security market of Iraq. A sample size of 138 business firms that have been operational for the period between 2015 and 2017. The findings uncovered a significant and positive correlation between voluntary audit rotation and the total discretionary accruals value implying that voluntary audit firm rotation significantly and negatively correlate with audit quality. Moreover, the study established that audit tenure negatively correlated with the absolute discretionary accrual value implying that audit tenure positively influenced and audit quality. However, there was no significant correlation between voluntary partner rotation and quality of audit services.

Junaidi, Hartono, Suwardi, Miharjo & Hartadi (2016) sought to test how auditor rotation and auditor tenure influence auditor independence in business organizations listed in Indonesia Stock Exchange between the period of 2002-2010. This study applied logistic regression to analyse its data, where the results were that, the auditor's tenure statistically had a significant negative correlation with the auditor independence. Furthermore, auditor rotation had significant positive influence on auditor independence.

In a study conducted in Nigeria, Bobbie, & Booker (2016) to explore how loaning officers perceive auditor independence and the influence of this independence on audit quality, the study experimented three audit firms as case studies, which practices auditor rotation. The semi-structured questionnaires were administered to 212 respondents, who were sampled through simple random sampled technique. Using descriptive statistics analysis, the study

established that majority of the loan officers perceived that when a company practices auditor rotation, then the auditor independence is also increased.

Mohamed & Habib (2020) studied Auditor Rotation and its effect on Quality and Independence in Egypt. Descriptive research design was implemented whereby data was collected and analysed by use of discrete-time analysis. Data were analysed using both descriptive and regression analysis. The study used questionnaires in data collection. The findings ascertained that audit rotation results in auditors' independence and subsequently enhanced quality of auditing services in various firms.

Similarly, Masika, (2019), conducted a study to assess the manner in which threat-based auditing quality influenced the efficiency of state corporations in Kenya. The study employed descriptive research approach in which data was gathered through questionnaires. From the study findings, there was a positive link between the quality of internal auditing and efficiency of state owned corporations. The Auditor rotation represented independent variable while audit quality was the dependent variable. However, the study found that all these variables were influenced by control variables such as additional Services, audit team characteristics, audit Quality Model, and factors associated with reporting.

Agunda, (2014) carried out a study to establish the association between auditor rotation and quality of audit services within the Kenyan banking sector. The study gathered primary data with the help of a questionnaires as well as using interviews. The population was the 43 commercial banks. Using descriptive statistics, the study computed means and standard while for inferential statistics the study used multiple regression approaches. From the result analysis, the study found that providing consultancy services registered the highest influence on quality of audit services the trailed by audit fees. The study also found that of the three variables, the auditor rotation recorded the least influence or insignificant effect on the quality of audit services

registering a comparatively smallest beta coefficient of the three predictors. Therefore, the study recommends that commercial financial institutions should have a shorter audit tenure given that fresh auditors will always come in with in new ideas.

Leposo, (2019) similarly carried out a study on auditor rotation and its influence on audit quality of Commercial banks. The study used a population of 43 registered commercial financial institutions in Nairobi Kenya. Questionnaires gathered quantitative primary data on the various audit quality factors as well as collecting data on independent variables. The study then used descriptive statistics to analyze data that were presented in form of frequency distributing tables to illustrate also the means and standard deviations. Inferential statistics used were regression and correlation coefficients. The analysis revealed a significant correlation between auditor rotation and quality of audit services given that the study recorded an overall statistical significance of 0.000. In fact, based on correlation analysis audit rotation recorded the highest correlation level with quality of audit services ($r=0.662$). However, audit fees and audit team characteristics did not register any significant at correlation with the quality of audit services.

2.5 Conceptual Model

The model in figure 2.1 illustrates the nature of correlation or association that exist between audit rotation, auditor independence and quality of audit services in Kenyan commercial banks. As per the model, the independent variables are shown by audit rotation dependent variable is shown by quality of audit services and auditor independence. The model illustrate that there is a direct effect of audit rotation on quality of audit services and auditor independence

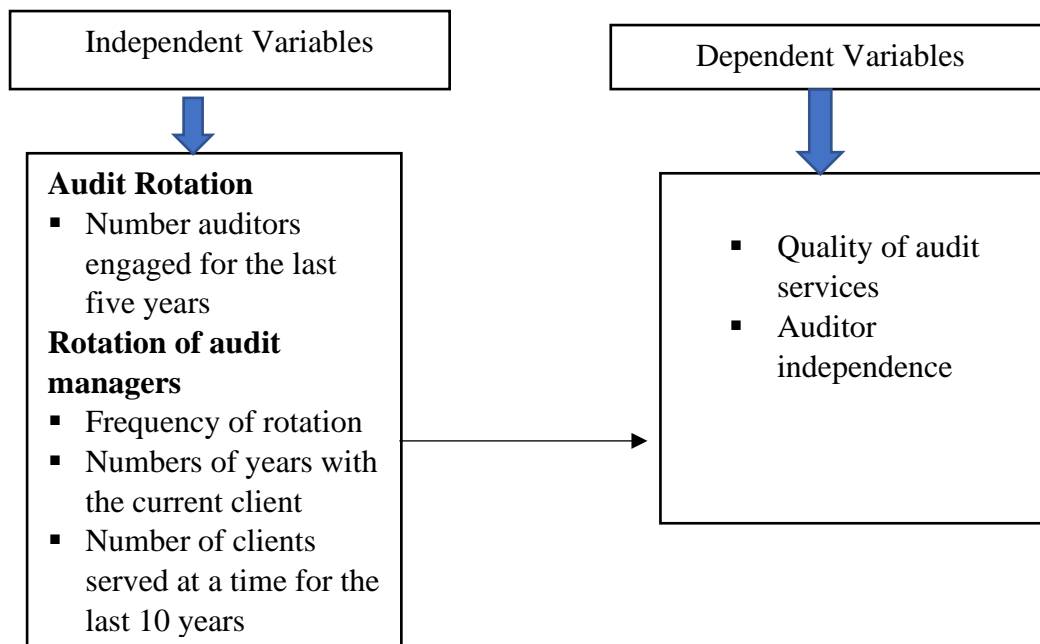


Figure 2.1: Conceptual model showing the relationship between the variables

2.6 Summary of Literature Review

The study highlighted both theoretical and review of past studies (empirical literature). The theories that guide the research are agency theory, the Assurance theory and policeman theory. The proponents, tenets and how these theories inform the study have been described in the study. The empirical reviews underscores how different scholars underpin the effect of audit rotation on audit independence and quality of audit services of different organizations, thereby critically creating knowledge gaps in these studies. Numerous previous studies conducted either locally or globally mainly focus on how different audit firms relates with different organization, with little attention on the rotation of these firms on auditor independence and quality of audit services on commercial banks in Kenya. Moreover, the reviewed empirical studies have used different methodologies hence giving inconsistent findings which may not be generalised in the present study. Some of the reviewed studies have also been done in areas outside Kenya hence creating contextual gaps and their findings cannot be applied for the present study. The present study will fill these gaps in literature by assessing how audit rotation influence auditor independence and quality of audit services in commercial banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter highlights the methodology that guides the present study. As such, an illustration of methodologies and study design that was used is provided. According to Saunders, *et al.*, (2019) explains that study approaches and techniques helps in data collection and appropriate analysis. Hence, this section provides into details the study design, population, sample sizes, data collection technique and analysis. It also highlights on the measurement of variables, models.

3.2 Research Design

The present study adopted descriptive study design. Mitchell & Jolley (2012) describe this design as a mode of research where both quantitative and qualitative kind of data is gathered and analysed in a descriptive manner to show how a particular phenomenon is trending and correlate the trend with various factors at that particular time. This design is chosen for the present study because it helps in making easier generalisation of the findings for the larger population. Another reason for the preference of this design is also lies in the premise that in business transaction, the association is usually unclear and hence, it is indispensable to get informed on the kind of relationships that is being studied, to clearly comprehend and manage the research variables, of which in the present scenario, audit rotation (independent variable) and auditor independence and quality of audit services (dependent variables).

3.3 Target Population

According to Ngechu (2004), target population is the specific group of persons, subjects or elements from which the study obtains its data. This implies that this group of people or

elements share similar characteristics. The target study population consisted of 42 commercial banks registered to undertake banking functions in Kenya (see Appendix I). Therefore, given the small number of the commercial banks in Kenya, the study used census sampling approach to involve the 43 senior managers in finance department of all the commercial banks as well as audit firm officials from the 24 registered audit firms in the country. This implies that the study randomly picked one senior manager in finance department of every bank.

3.4 Data Collection

This study seeks to use primary source of data in form of questionnaires. The questionnaires were structured in such a way that they reflect both open-ended and closed questions as open ended questions assist in elaborately answering the questions while closed type guides the research respondents on prompt responses. Besides, questionnaires guarantee the respondents of their confidentiality, saves time and are effortlessly administered. Questionnaires were given to 43 senior finance managers of commercial banks and 24 audit firm officials for quantitative data.

3.5 Significance Test

A *t*-test is a statistical assessment used to carry out a comparison between the actual mean and the populace mean. It can also be described as the baseline mean, with respect to standard deviation. In the present study, regression analysis used *t*-statistic, at a 5% significance level.

3.5.1 F-tests

F-test is utilised in any statistical work to illustrate how the data are distributed (F-distribution) as guided by valueless hypotheses. Normally it is applied when correlating statistical designs that fit very well in the data set, so as to pick out the model that fits very well with the study sampled population. As per the present study, the F-test statistical analysis checked whether all

predictors variables (audit rotation) fits very well with the auditor dependency and quality of audit services, in which the F value was computed through at 95% confidence level.

3.6 Data Analysis

The study used SPSS version 26 as a platform to analyse the data. The data was analysed through descriptive statistics in form of mean, frequencies and percentages, as well as multiple linear regression analysis. This helped in establishing the nature of association that exist between audit rotation and auditor dependency and quality of audit services.

3.6.1 Empirical model

Therefore, the overall econometric model was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where;

Y1 = Auditor Independence measured through level of autonomous in decision making

Y2= Quality of audit services measured through relevance and reliability

X1 = Auditor rotation measured through the frequency of rotation or substitution of the auditors and audit firms

X2 = Audit Team Characteristics measured through attributes such as professionalism and integrity

X3 = Extra/additional services

e= Error of prediction

β_0 = Constant. Value of dependent variable; auditor Dependency and Quality of Audit Services, holding all the independent attributes constant at zero. β_1 , β_2 , β_3 ,= represent regression

coefficients of independent variables, denoting the variant rate in the dependent variable for every change in the independent variable;

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter covers the study results. It is divided into various sections which include descriptive of the study, response rate, analysis of variance, correlation, regression coefficients and lastly the summary of findings.

4.2 Response Rate

A total of forty-three questionnaires were used to gather primary data from the registered forty- three commercial banks in Nairobi County, of which only 39 were filled and returned from the financial managers of the respective banks. This translates to 90.7% which deemed sufficient to undertake the analysis. On the other hand, out of the 24 registered audit firms that were involved in the study, 14 audit firm officials returned the questionnaires duly filled for quantitative analysis. This implies that a return rate of 58.3% of the audit firm officials were realized for the study.

4.3 Reliability Test

Data validity is a crucial aspect especially when you use a tool that has a Likert scale. Cronbach's Alpha was used in establishing the reliability of the questionnaire whether it has internal consistency.

Table 4.1: Reliability Test Out put

Cronbach's Alpha	.741
Cronbach's Alpha Based on Standardized Items	.740
N of Items	17

From the study, the results show a 0.741 value from the 16 items that used the scale which indicates a 74.1 % reliability of the scale used to collect data. According to many methodologists it endorses a

minimum α coefficient between 0.65 and 0.8 (or higher in many cases); α coefficients that are less than 0.5 are usually unacceptable, especially for scales seeming to be unidimensional.

4.4 Descriptive Statistics

Descriptive statistics are used for data description collected from the study based mostly on the frequencies and percentages, mean and standard deviation.

4.4.1 Audit Firm Official Response on Audit Rotation (n=14)

Respondents (Audit Firm Officials) were probed on various questions related to audit rotation. Table 4.2 shows the response

Table 4.2: Audit Firm Official Response on Audit Rotation

		Frequency	Percentages
Currently engaged by any of the commercial banks	Yes	11	78.57
	No	3	21.43
Duration of engagement with the current commercial banks	1- 5 years	8	72.73
	6-10 years	3	27.27
	Above 10 years	0	0.00
Have worked for a client before the current client	Yes	9	81.82
	No	2	18.18
Number of Rotations by the previous firms	Once	1	7.14
	Twice	3	21.43
	More than twice	10	71.43
Have been rotated by the current firm	Yes	8	72.73
	No	3	27.27

The study found that out of the 14 audit firms that took part in the study, majority at 11(78.57%) were presently engaged by commercial banks, while only 3(21.43%) indicated otherwise. On duration of engagement with the current commercial banks, majority at 8(72.73%) indicated that they have been with commercial firms between 1-5 years, 3(27.27%) indicated 6-10 years, while none of the respondents indicated above 10 years. When probed on whether they had worked for a client before the current client, out of the 11 audit firm officials that were currently engaged by the commercial banks, majority at 9(81.82%) indicated that they worked for a client before, while only 2(18.18%) indicated otherwise. This

shows that most of the audit firms had worked for other clients/firms before and hence were experienced enough. On the number of rotations, majority of the response majority of the respondents at 10(71.43%) indicated that they had been rotated more than twice for the last 5 years, 3(21.43%) indicated twice, 1(7.14%) indicated once. This shows that most audit firms were rotated by their clients quite often and this affected positively on the quality of audit services and independency. In fact, 8(72.73%) of the audit firms revealed that they have been rotated by the current firm while only 3(27.27%) indicated otherwise.

4.4.2 Audit Rotation on Audit Quality and Auditor Independency

Respondents were also probed on their opinion on how audit rotation affect the quality of audit services and auditor independency. The response was as shown in Figure 4.1

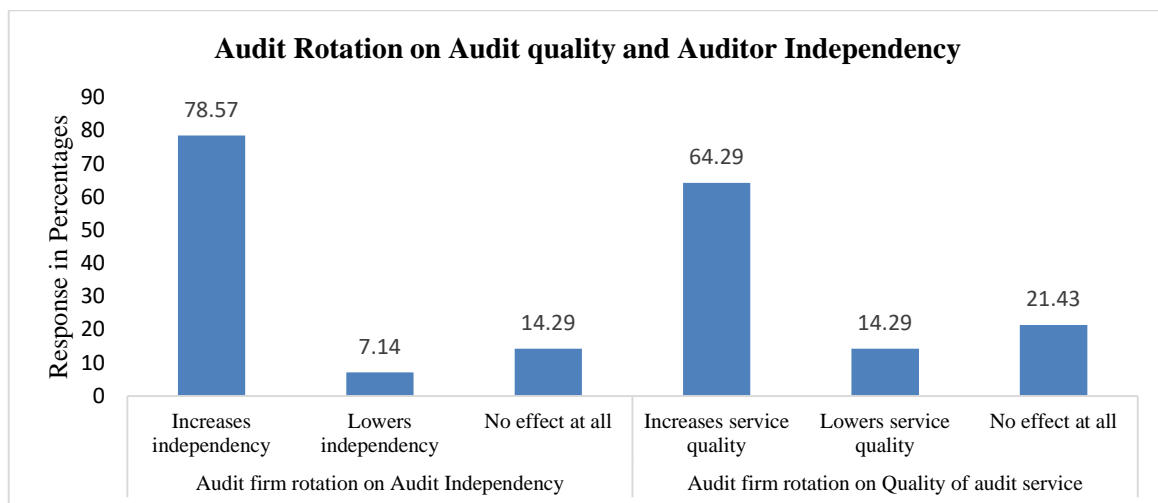


Figure 4.1: Audit Rotation on Audit Quality and Auditor Independency

The study found that majority of the respondents at 78.57% agreed that audit firm rotation increases their independency when discharging their duties, 14.29% indicated that there were no effect at all, while only 7.14% indicated that auditor rotation lower independency. On quality of audit services, the study found that more than two thirds at 64.29% indicated that auditor rotation increases quality of audit services, 21.43% indicated no effect at all, while 14.29% indicated that the practice of audit rotation lowers service quality.

4.4.3 Additional Services

Respondents of both commercial banks finance managers and audit firm officials were asked to indicate their opinion on whether they agreed or disagreed with the additional services as a determinant of audit quality. Table 4.3 show the response

Table 4.3: Additional Services

Statement	Yes		No	
	Frequency	%	Frequency	%
Human resource consulting services	28	52.8%	25	47.2%
Information system design and implementation services i.e data migration tips	35	66.0%	18	34.0%
Business/management consulting services	41	77.4%	12	22.6%
Book keeping advisory services	33	62.3%	20	37.7%
Tax advisory/compliance and planning services	37	69.8%	16	30.2%

Majority of the respondents (both bank managers and the audit firm officials) at 28(52.8%) confirmed that the audit firms sometimes were engaged in additional services like human resource consultancy service, while 25(47.2%) disagreed that such consultations never happened. Over two thirds of the respondents at 35(66.6%) also agreed that audit firms could sometimes be engaged as an additional service on information system design and implementation services such as data migration tips. Only 18(34.0%) indicated otherwise. Over three quarters of the respondents at 41(77.4%) similarly confirmed that audit firms would also offer consultancy services in business/management as an additional service during the audit period, while only 12(22.6%) refuted to the statement. Majority of the respondents also agreed that audit firms would also offer additional services in book keeping as shown by 33(62.3%) and tax advisory/compliance and planning services as shown by 37(69.8%). Only 20(37.7%) and 16(30.2%) disagreed that the firms were not engaged in such services. From these findings, it is evident that most audit firms were engaged in various additional services

while carrying out their main audit duties to the commercial banks.

4.4.4 Audit Team Characteristics

Both commercial banks managers and audit firm officials were asked to indicate their level of agreement with the following statements relating to the audit team characteristics. Audit team characteristics may also influence the audit quality and auditor independency. Table shows the response.

Table 4.4: Audit Team Characteristics

Statement	SA	A	N	D	SD	Mean	SD
The auditors are familiar with the business requirements as well as the Bank's operations, including operational issues.	34 (64.15%)	8 (15.09%)	7 (13.21%)	3 (5.66%)	1 (1.89%)	4.34	0.82
They are capable of making independent decisions and meeting the expectations of stakeholders.	20 (37.74%)	14 (26.42%)	4 (7.55%)	6 (11.32%)	9 (16.98%)	3.57	0.87
The auditors have the necessary experience and are good communicators.	31 (58.49%)	8 (15.09%)	9 (16.98%)	3 (5.66%)	2 (3.77%)	4.19	0.84

According to the study findings in Table 4.4, majority of the respondents at 34(64.15%) strongly supported the statement that auditors are familiar with the business requirements as well as the Bank's operations, including operational issues, 8(15.09%) just agreed with the statement, 7(13.21%) remained neutral while 4(7.55%) cumulatively disagreed with the statement. This shows that with a mean of 4.35 and SD=0.82; both the commercial bank officials and audit firm officials acknowledged that auditors are familiar with the business requirements as well as the bank's operations and hence would provide quality audit services to the firm.

Majority of the respondents at 20(37.74%) strongly supported the statement that auditors engaged by the commercial banks were capable of making independent decisions and meeting the

expectations of stakeholders, 14(26.42%) agreed with the statement, while 4(7.55%) remained neutral. On the contrary, 6(11.32%) disagreed, while 9(16.98%) strongly disagreed with the statement. Overall, (Mean 3.57; SD=0.87) shows that auditors were capable of making independent decisions and meeting the expectations of stakeholders and their clients.

The study also uncovered that majority of the respondents at 31(58.49%) strongly agreed that the auditors have the necessary experience and are good communicators, 8(15.09%) just confirmed the statement while 9(16.98%) were undecided on the statement. Only 5(9.43%) disagreed with the statement. Generally, most of the respondents (Mean 4.19; SD=0.84) confirmed that auditors that they engaged had the required experience and expertise to carry out their duties for quality outcome.

4.4.5 Quality of Audit Services

Respondents of both bank managers and audit officials were required to indicate their level of agreement with the following statement relating to most recent audit performed by external auditors, On a scale of 1 to 5, where: 1 = SD Strongly Disagree; 2 = Disagree; 3 = Neutral; 4 = Agree; 5 = Strongly Disagree. Table 4.5 shows the response

Table 4.5: Quality of Audit Services

Parameter	Question	SD	D	N	A	SA	Mean	SD
Audit inputs	The audit was conducted in compliance with auditing and ethical norms.	6 11.32%	8 15.09%	10 18.87%	19 35.85%	10 18.87%	3.66	0.77
	The auditor is a highly qualified and unbiased professional.	2 3.77%	4 7.55%	6 11.32%	28 52.83%	13 24.53%	3.87	0.70
	Industry experience of audit firms	4 7.55%	2 3.77%	8 15.09%	30 56.60%	9 16.98%	3.72	0.71
Audit Process	Investing in the infrastructure that supports quality auditing, such as technology and technique, has a number of advantages.	2 3.77%	3 5.66%	4 7.55%	3 5.66%	41 77.36%	4.47	0.62
	The audit work is decided by a thorough planning process and is subject to evaluation before being completed, i.e. Engagement control quality reviews.	5 9.43%	3 5.66%	8 15.09%	31 58.49%	6 11.32%	3.57	0.74
	Compliance with the requirements for independence	2 3.77%	4 7.55%	7 13.21%	29 54.72%	11 20.75%	3.81	0.72
Audit output/Results	The audit opinions, financial statements, and annual reports are complete and correct, with no errors or restatements.	4 7.55%	4 7.55%	6 11.32%	32 60.38%	7 13.21%	3.68	0.73
	Internal control and going concern weaknesses must be reported on time.	5 9.43%	3 5.66%	32 60.38%	6 11.32%	7 13.21%	3.13	0.81
Communications in financial reporting supply chain	Communication between the audit team and those in charge of governance is adequate and timely.	2 3.77%	7 13.21%	10 18.87%	29 54.72%	5 9.43%	3.53	0.79

The study found that majority of the respondents at 19(35.85%) agreed that the audit that was conducted by the previous auditor in compliance with auditing and ethical norms, 10(18.87%) strongly agreed, while another 10(18.87%) remained neutral. Only 8(15.09%) disagreed while only 6(11.82%) strongly disagreed. This shows that the auditing services provided to the commercial banks were quality and acceptable (Mean 3.66; SD =0.77).

When probing on the qualification and professionalism of the auditors, 28(52.83%) of the respondents agreed that the auditor was a highly qualified and unbiased professional and was

good in their duties, 13(24.53%) strongly agreed with the statement, while 6(11.32%) remained neutral. Only 4(7.55%) indicated disagreed while 2(3.77%) strongly disagreed. Generally, the auditors were highly qualified and professional (Mean 3.87; SD=0.70).

The study established further that majority of the respondents at 30(56.60%) agreed that the commercial experience with the audit firms as good, 9(16.98%) strongly agreed with the statement, while 8(15.09%) remained neutral. Only 4(7.55%) strongly disagreed as 2(3.77%) disagreed average. Overall, with a mean of 3.72 and SD=0.71, it shows that the banking industry experience and history with the audit firms have been good, owing to the audit quality of services they offer to the banks.

On investment on technological infrastructure, the study found that investing in the infrastructure that supports quality auditing, such as technology and technique for a number of advantages among the commercial banks was as was strongly agreed with by majority of the respondents at 41(77.36%). On the other hand, 4(7.55%) remained neutral on the statement, 3(5.66%) disagreed while only 2(3.77%) strongly disagreed. This shows that commercial banks had invested so well in technological infrastructure that supports quality auditing (Mean 4.47; SD=0.62).

The study also found that on the statement of *“The audit work is decided by a thorough planning process and is subject to evaluation before being completed, i.e. Engagement control quality reviews”*, majority of the respondents at 31(58.49%) agreed with the statement, 6(11.32%) strongly supported the statement, while 8(15.09%) remained neutral on the statement. Only 8(15.09%) cumulatively disputed the statement. With a mean of 3.57 and SD=0.74, it clearly shows that in most commercial banks audit work is decided by a thorough planning process and is subject to evaluation before being completed, i.e. Engagement control quality reviews.

On compliance with the requirements, the study found that majority of the respondents at 29(54.72%) agreed with the statement that compliance with the requirements for independence, 11(20.75%) strongly agreed, while 7(13.21%) remained neutral on the statement. Only 4(7.55%) disagree, while 2(3.77%) strongly disagreed. Overall, most of the commercial banks were in compliance with the requirements for independence (Mean 3.81; SD=0.80).

Majority of the respondents at 32(60.38%) agreed with the statement that the audit opinions, financial statements, and annual reports are complete and correct, with no errors or restatements, 7(13.21%) strongly agreed with the statement, while 6(11.32%) remained neutral. Only 4(7.55%) disagreed with the statement while another 4(7.55%) strongly agreed with the statement. This shows that most commercial banks had quality audit outcome characterised by minimal errors or restatements (Mean 3.68; SD=0.81).

Majority of the respondents at 32(60.38%) also strongly agreed with the statement that internal control and going concern weaknesses must be reported on time, 6(11.32%) just agreed, while 7(13.32%) remained neutral on the statement. Cumulatively, only 8(15.09%) disagreed with the statement. This implies that most commercial banks would report the weaknesses in internal control in time for good audit output (Mean, 4.08; SD=0.61).

The study also uncovered that majority of the respondents at 29(54.72%) agreed that communication between the audit team and those in charge of governance is adequate and timely, 5(9.43%) strongly agreed while 10(18.87%) remained neutral on the statement. Only 7(13.21%) disagreed while 2(3.77%) strongly disagreed. With a mean of 3.53 and SD of 0.79, it shows that the communication between the audit team and those in charge of governance of the commercial banks is adequate and timely.

4.5 Inferential Statistics

Inferential statistics are used to define properties of population by trying to make predictions from the data collected. Statistical models used include t-tests, ANOVA regression analysis, and other various models depending on the study.

4.5.1 Audit Rotation and Quality of Audit Services

Regression analysis was done with the auditor rotation and Quality of Audit Services in commercial banks in Kenya. There were three predictors as explanatory variables: Audit rotation, Audit Team Characteristics and Extra/additional services. The results are presented as in table 4.6 below

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.718 ^a	.516	.510	.14934

Source: Research Findings (2022)

According to Table 4.6 the value of R square is .516; this implies that 51.6% change in quality of audit service is explained by Audit rotation, Audit Team Characteristics and Extra/additional services. It also means that other than these variables (Audit rotation, Audit Team Characteristics and Extra/additional services) there are also other factors which affect the quality of audit service in commercial banks in Kenya. Table 4.8 gives the findings of the ANOVA.

4.5.2 Analysis of Variance (ANOVA)

Table 4.7: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	26.174	3	8.724	34.619	0.000 ^b
Residual	12.593	50	0.252		
Total	38.767	53			

Source: Research Findings (2022)

As per Table 4.7, the value of F calculated is given as 34.619 with p-value as 0.000 which is ($p < 0.05$). This portray that Audit rotation, Audit Team Characteristics and Extra/additional services significantly predict quality of audit services offered to commercial banks in Kenya. Results on the beta coefficients and significance were determined and summarized as shown in Table 4.8.

Table 4.8: Coefficients and Significance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	19.51	0.654		29.88	0.000
1 Audit rotation	0.633	0.143	0.631	4.43	0.000
Audit Team Characteristics	0.481	0.151	0.473	3.19	0.038
Extra/additional services	0.578	0.145	0.619	3.97	0.028

Source: Research Findings (2022)

Table 4.8 shows that audit rotation ($\beta = .633$, $t > 1.96$; $p < 0.05$) had the largest significant effect on quality of audit service offered to commercial banks in Kenya followed by additional services offered ($\beta = .578$, $t > 1.96$; $p < 0.05$) then audit team characteristics ($\beta = .481$, $t > 1.96$; $p < 0.05$). Thus, audit rotation, audit team characteristics and extra/additional services covered in this study had significant contribution towards quality of audit service offered to commercial banks in Kenya.

4.6 Discussion of findings

The study objective was to analyze the effect of firm audit rotation and audit quality. The study employed descriptive statistics and multiple regression analysis, which is used for analyzing the data as it showed the impact of audit rotation on audit quality and it included the model summary, analysis of variance table and the regression coefficients.

The first independent variable was audit rotation ($\beta = .633$, $t > 1.96$; $p < 0.05$). The significance value being $p < 0.05$ indicated that audit rotation had a significance related to quality of audit services offered to commercial banks in Kenya. Mandatory rotation of audit firms is to be considered as important in enhancing auditor independence as there is a significant relationship between them and their effect on audit quality. Based on a study by Beyanga (2011), reduced

levels of overheads, identification of ways to reduce overheads are achieved through AR which in the long run helps improve levels of financial performance. For management to achieve improved performance, there is a need for the adoption of auditor rotation.

The second variable was audit team characteristics. Audit team characteristics are known to enhance audit quality and therefore this study found that ($\beta=.481$, $t>1.96$; $p<0.05$) implying that audit team characteristics have a positive effect on quality of audit services. According to professional committees, to dictate material misstatements, there is a need for a very close evaluation of the individuals' integrity as well those assigned to carry out the engagements as a way to assist the detection of material misstatements. Further, Agunda, (2014) explains that for any professional auditor to detect financial misstatements in audited organization, the said audit team must as well possess integrity at individual level. This is because, the team is composed of personnel that has more degree of professionalism and hence is high likely to perform their roles in auditing properly without missing any auditing step. Moreover, any audit staff who upholds high levels of professionalism and integrity is less likely to use insufficient evidence for their judgment (Agunda, 2014).

The third variable, was additional audit services of consultancy services. The study found that ($\beta=.578$, $t>1.96$; $p<0.05$), indicating that it was a significant factor in quality of audit services offered to commercial banks. In auditing practice, pricing is highly influenced by the amount of services provided by the audit firm. When an auditor receives of large amount of payment that are not associated with the auditing practice, he or she may tend to compromise the level of independence as a result of high degree of bondage financially, because he or she feels he owes the audited organizations (Onwuchekwa, Erah, & Izedonmi, 2012). This echoed with what was reported by (Wooten, 2003), where additional services provision has been proved to have a direct relationship to improved quality of audits.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings, conclusions and recommendations. It details a brief discussion of the main findings and conclusions made based on the analysis, policy implications and suggestions for further research of the study with regards to the effect of audit rotation, audit team characteristics and extra/additional services on quality of audit services offered to commercial banks in Nairobi County.

5.2 Summary of the Findings

Companies are kept in line mainly by auditors who act as watchdogs of the owners. This applies also for banks who are entrusted with so many financial responsibilities especially by their clients who are majorly their customers. The audit report provides a true and fair view of the auditor's opinion based on the financial statements provided by management of banks. This report is availed to the general public and the shareholders thus the quality of the report should be free of material error and should be independent of any bias. This study, therefore, sought to establish the effect of audit firm rotation on the quality of the audit work done in commercial banks.

The literature review of this study outlined the theories that were relevant and also analyzed the empirical studies previously done by other researchers in the topic area noting the methodology and outcomes. The literature review also assisted the study in identifying variables that were used in the research analysis and forming the conceptual framework of the study. The variables that were used were audit rotation, provision of additional services, and audit team characteristics.

Primary data was the main source of data where a questionnaire was administered to the financial managers of the commercial banks under this study and audit firm officials. The study established that 53 of the respondents (financial managers and audit firm officials) responded to the questionnaires which was sufficient to continue and analyze the data. The data collected was then verified, coded and analyzed by use of SPSS software. Descriptive statistics and inferential statistics were then calculated and results interpreted. The means and standard deviations were calculated for descriptive data and multiple regression analysis was used to analyze the relationship between the variables. A validity test was also conducted using Cronbach's alpha test which in our case was 0.741 which was good.

The first independent variable was audit rotation ($\beta=.633$, $t>1.96$; $p<0.05$). The significance value being $p<0.05$ indicated that audit rotation had a significance related to quality of audit services offered to commercial banks in Kenya. The second variable was audit team characteristics. Audit team characteristics are known to enhance audit quality and therefore this study found that ($\beta=.481$, $t>1.96$; $p<0.05$) implying that audit team characteristics have a positive effect on quality of audit services. The third variable, was additional audit services of consultancy services. The study found that ($\beta=.578$, $t>1.96$; $p<0.05$), indicating that it was a significant factor in quality of audit services offered to commercial banks. In auditing practice, pricing is highly influenced by the amount of services provided by the audit firm

5.3 Conclusions

Auditors play a crucial role in banks and other companies so as to keep in check as to how the operations are being carried out which is beneficial to the owners and shareholders. The study through the research gap identified the research objective which was to identify the effect of audit firm rotation and audit quality. From the data analysis done and the results presented, it revealed audit rotation had a significant influence on quality of audit services offered to the

commercial banks with short audit tenure in our case 1- 5 years being better for banks as the audit quality improves. The study findings also indicated that presence of additional services. The additional services like tax compliance, human resource, bookkeeping, and others, had an effect on audit quality with a significant value meaning auditors offering additional services help achieve the quality of audit done in the banks. Finally audit team characteristics that entailed professionalism and integrity had a positive effect on quality audit services.

5.4 Recommendations of the Study

The study recommends audit quality be achieved other stakeholders should be involved not only the financial managers. This would help boost the audit quality done by auditors to their clients. Making audit rotation mandatory would help increase efficiency and improve audit quality in the long run. A centralized audit rating agency would provide objective information as opposed to asking a staff member what they think was the quality. This would help improve audit quality provided by the firms and help improve the accountability of managers who are agents of shareholders.

From the study findings, the study also recommends that audit firms should provide other additional services so as to improve audit quality. These services not only improve audit quality but also increase the profit levels of the banks. Since auditors are informed on what areas are important for performance and audit, they would help in improving a company. The study also recommends on sensitizing on the independence of the auditors and their competence to do their due diligence in executing their work.

Despite most banks feeling that the audit fees charged are quite high, the auditors should ensure that the quality of the work corresponds with the fees they charge therefore banks could strike a balance and price the audit work based on the quality.

5.5 Limitations of the study

One of the drawbacks the study encountered was the respondents were not 100% despite the numbers being sufficient to continue with the analysis of the study. With a higher response rate, the margin of error is always reduced as the sample characteristics are always near the population characteristics.

The second drawback of the study was the precision of analysis when dealing with ordinal data. Measurements of some of the variables are in ordinal scale so as to capture some of the relevant information but they are not as accurate as to scale measurement. Also some of questions had different measurements for example use of yes or no while still using a Likert scale of strongly agree to strongly disagree.

5.6 Suggestions for Further Research

The study suggests more analysis be undertaken with regards to audit quality utilizing other measures like Chi-square and not necessarily econometric models which can also be employed to determine the effect of audit rotation on audit quality. Other variables may also be identified in future studies and their impact on audit quality-analyzed in order to depict better R^2 values of at least above 80% which will show a strong relationship between the independent and the dependent variable.

The study could also involve other respondents like managers who would answer the questionnaire better and even incorporate some demographic characteristics of the banks.

The study should also look at other sectors of the economy that engage in audit services which will present a holistic approach to the status of audit quality in Nairobi and other geographical areas in the country.

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APPENDICES

Appendix 1 Questionnaire for Bank senior manage

r

This questionnaire was created to gather data on the impact of auditor rotation on performance among Kenyan commercial banks. Please read the questions attentively and respond as truthfully as possible. The information gathered will be used solely for academic research purposes and will be kept in strict confidence.

Section A: Auditor Rotation

1. For how long have you been engaging your present auditor?

1 – 5 years

6 – 10 years

Over 10 years

2. How many external auditors has your organization hired in the last five years??

3. What are your thoughts on audit firm rotation, whether mandated or voluntary?

SECTION B: Additional Services

Statement	Yes	No
1. Human resource consulting services		
2. Information system design and implementation services i.e data migration tips		
3. Business/management consulting services		
4. Book keeping advisory services		
5. Tax advisory/compliance and planning services		

SECTION C: Audit Team Characteristics

Kindly show your level of agreement with the following statement related to audit team characteristics

Statement	SA	A	N	D	SD
1. The auditors are familiar with the business requirements as well as the Bank's operations, including operational issues.					
2. They are capable of making independent decisions and meeting the expectations of stakeholders.					
3. The auditors have the necessary experience and are good communicators.					

SECTION D: Quality of Audit Services

Based on the following four factors, how would you rank the most recent audit performed by external auditors? On a scale of 1 to 5, please specify where: 1 = Poor; 2 = Average; 3 = Acceptable; 4 = Good; 5 = Outstanding

Parameter	Question	1	2	3	4	5
1.Audit inputs	<ul style="list-style-type: none"> i. The audit was conducted in compliance with auditing and ethical norms. ii. The auditor is a highly qualified and unbiased professional. iii. Industry experience of audit firms 					
2.Audit Process	<ul style="list-style-type: none"> i. Investing in the infrastructure that supports quality auditing, such as technology and technique, has a number of advantages. ii. The audit work is decided by a thorough planning process and is subject to evaluation before being completed, i.e. Engagement control quality reviews. iii. C. Compliance with the requirements for independence 					
3.Audit output/Results	<ul style="list-style-type: none"> i. The audit opinions, financial statements, and annual reports are complete and correct, with no errors or restatements. ii. Internal control and going concern weaknesses must be reported on time. 					
4.Communications in financial reporting supply chain	Communication between the audit team and those in charge of governance is adequate and timely.					

Appendix 2 Questionnaire for Audit Managers

This questionnaire was created to gather data on the impact of auditor rotation on performance among Kenyan commercial banks. Please read the questions attentively and respond as truthfully as possible. The information gathered will be used solely for academic research purposes and will be kept in strict confidence.

Section A: Auditor Rotation

1. Are you currently engaged with any of the commercial bank?

- Yes []
- No []

1b. If yes for how long have you been engaged with your present client/firm?

1 – 5 years

6 – 10 years

Over 10 years

2. Other than the client/firm mentioned above, is there any firm you had worked for before?

- Yes []
- No []

3. Prior to the current firm, how many times have you been rotated by previous firms?

- Once []
- Twice []
- More than twice []

4. Prior to your current engagement with the present firm, have you been rotated by the current firm/client before?

- Yes []
- No []

5. What are your thoughts on audit firm rotation, whether mandated or voluntary on your independency?

- Increases independency []
- Lowers independency []
- No effect at all []

6. What are your thoughts on audit firm rotation, whether mandated or voluntary on your service quality?

- Increases service quality []
- Lowers service quality []
- No effect at all []

SECTION B: Additional Services

Kindly indicate whether you also offer additional services in the following areas

Statement	Yes	No
1. Human resource consulting services		
2. Information system design and implementation services i.e data migration tips		
3. Business/management consulting services		
4. Book keeping advisory services		
5. Tax advisory/compliance and planning services		

SECTION C: Audit Team Characteristics

Kindly show your level of agreement with the following statement related to audit team characteristics

Statement	SA	A	N	D	SD
1. The audit team are familiar with the business requirements as well as the Bank's operations, including operational issues.					
2. The audit team capable of making independent decisions and meeting the expectations of stakeholders.					

3. The audit team have the necessary experience and are good communicators.					
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SECTION D: Quality of Audit Services

Based on the following four factors, how would you rank the most recent audit service you performed to the current client? On a scale of 1 to 5, please specify where: 1 = Poor; 2 = Average; 3 = Acceptable; 4 = Good; 5 = Outstanding

Parameter	Question	1	2	3	4	5
1.Audit inputs	iv. The audit was conducted in compliance with auditing and ethical norms. v. The auditor is a highly qualified and unbiased professional. vi. Industry experience of audit firms					
2.Audit Process	iv. Investing in the infrastructure that supports quality auditing, such as technology and technique, has a number of advantages. v. The audit work is decided by a thorough planning process and is subject to evaluation before being completed, i.e. Engagement control quality reviews. vi. C. Compliance with the requirements for independence					
3.Audit output/Results	iii. The audit opinions, financial statements, and annual reports are complete and correct, with no errors or restatements. iv. Internal control and going concern weaknesses must be reported on time.					
4.Communications in financial reporting supply chain	Communication between the audit team and those in charge of governance is adequate and timely.					

Appendix 3. List of Commercial Banks

1. ABC Bank
2. African Banking Corporation
3. African Development Bank Group
4. Afrika Investment Bank
5. Bank of Africa Kenya Ltd
6. Bank of Baroda (Kenya) Ltd.
7. Central Bank of Kenya
8. CFC Stanbic Bank Limited
9. Chase Bank
10. Citibank N A
11. Commercial Bank of Africa
12. Consolidated Bank
13. Co-operative Bank
14. Development Bank of Kenya Ltd
15. Dry Associates Limited
16. Dubai Bank Kenya Ltd
17. Dyer & Blair Investment Bank
18. Equatorial Commercial Bank Limited
19. Equatorial Investment Bank
20. Equity Bank
21. Faida Investment Bank – FIB
22. Fidelity Bank
23. Fina Bank
24. Giro Commercial Bank Ltd
25. Guardian Bank Ltd.
26. Housing Finance
27. Imperial Bank Limited
28. Investments & Mortgages Bank Limited – I&M Bank
29. KCB Bank
30. Kenya Post Office Savings Bank
31. K-Rep Bank
32. National Bank
33. NIC Bank
34. Oriental Commercial Bank Ltd.
35. Paramount Bank
36. Prime Bank
37. Standard Chartered
38. Standard Investment Bank
39. Sterling Investment Bank
40. Suntra Investment Bank Ltd
41. UBA Kenya Bank Ltd