

An Examination Of The Audit Quality Difference Among Big 4 Audit Firms In Kenya (An Audit Committee's Perspective)

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Abstract

The purpose of this study is to examine whether audit quality differences exist among the Big 4 audit firms in Kenya. The study also evaluates the extent to which audit committees (ACs) review the quality of work of the external auditor as required by the Corporate Governance Guidelines (CGGs) provided by the Capital Markets Authority (CMA). One way Analysis of Variance (ANOVA) technique is used to evaluate audit quality differences among Big 4 audit firms based on the questionnaire responses obtained from AC members of companies quoted on the Nairobi Securities Exchange (NSE). Percentage analysis is used to assess the extent to which ACs perform certain quality review checks on the work of external auditors as per the Centre for Audit Quality (CAQ) tool. This study contributes to the body of audit quality literature by examining audit quality using a new tool developed for ACs by the Centre for Audit Quality (CAQ). This methodology is in contrast to other audit quality proxies such as frequency of litigation occurrences, audit fees, audit tenure, size of discretionary accrual, extent of IPO under pricing and frequency of financial statement restatements that have been used in prior audit quality research. The study finds that there are no statistically significant audit quality differences among the Big 4 audit firms in Kenya. The study confirms the proposition used in prior researches on audit quality that Big 4 audit firms provide homogenous audit quality. The study also finds that ACs, to a large extent, review the quality of work of external auditors as per the CAQ tool.

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List of Abbreviations

AC – Audit Committee

ANOVA – Analysis of Variance

CAQ – Center for Audit Quality

CGG – Corporate Governance Guidelines

CMA – Capital Markets Authority

CPA – Certified Public Accountant

E&Y – Ernst & Young

ERC – Earnings Response Coefficient

IAASB – International Auditing and Assurance Standards Board

ICPAK – Institute of Certified Public Accountants of Kenya

IFRS – International Financial Reporting Standard

IPO – Initial Public Offering

ISA – International Standards on Auditing

NSE – Nairobi Securities Exchange

PCAOB – Public Company Accounting Oversight Board

PwC – PricewaterhouseCoopers

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CHAPTER ONE

INTRODUCTION

1.1 Introduction

The purpose of this chapter is to present the background and justification for this study. Audit quality studies have tended to focus on the audit quality differences between Big 4 and non-Big 4 audit firms with the conclusion that Big 4 audit firms homogenously provide higher audit quality than their non-Big 4 counterparts (Davidson & Neu, 1993; Khurana & Raman, 2004; Levintis & Caramanis, 2005; Sun & Liu, 2010; Lennox & Pittman, 2011). This study aims to determine whether Big 4 audit firms provide homogenous audit quality as has been suggested by extant research.

This chapter is organized as follows. The first section is the background of the study. It defines what the Big 4 audit firms are, discusses the basis and guidance standard of an audit and briefly describes the theory that emphasizes the importance of audit quality. The definition of audit quality and an analysis of audit quality variables are presented. A discussion of the role of the AC in ensuring audit quality then follows. Key critiques of audit quality are then highlighted. The conclusion of the background introduces the second section that is the problem statement. In this section, the justification and research gap of the study is highlighted. The third section states the objectives of the study followed by the fourth section that identifies the research questions. The fifth section describes the scope of the study followed by a section describing the significance of the study to various interested groups. The section capturing the motivation of the study concludes this chapter.

1.2 Background

According to Stuart (2013), the Big 4 audit firms (PricewaterhouseCoopers, Ernst & Young, KPMG and Deloitte and Touche) are at times known as the "Final Four" because of the strong belief of a low likelihood that regulators will allow further mergers of the accounting industry and that non Big 4 audit firms will not be able to compete with the

Big 4, as there is a market perception that they are not reliable as advisors or auditors to the largest companies.

Deangelo (1981) defines audit quality as the ability to first, detect misstatements and errors in financial statement and second, report these material misstatements and errors. Existing research on audit quality has examined the audit quality difference between Big 4 and non-Big 4 audit firms and most researchers concluded that Big 4 audit firms provide higher quality audits (Deangelo (1981); Davidson and Neu (1993); Colbert and Murray, 1998; Lennox and Pittman (2011)).

There exists an agency relationship between shareholders and directors of a company. According to Jensen and Meckling (1976), an agency relationship is a binding agreement in which one party (the principal) engages another party (the agent) to act on their behalf. The principal delegates decision making responsibilities to the agent. In the case of a public company, the shareholders, who are the owners of the company, are the principals. The directors are the agents. Directors appoint a management team to administer the operations of the company on their behalf. Anthony and Govindarajan (2007) identify two types of risks present in the agency relationship to be moral hazards and adverse selection. Moral hazard is a situation where the agent has a tendency to take up risks since the costs incurred will be felt by the principal. On the other hand, adverse selection occurs when, due to information asymmetry, the agent makes decisions beneficial to the self but to the detriment of the principal.

According to Anthony and Govindarajan (2007), mitigation of the management failures that may arise from moral hazards and adverse selection, shareholders monitor the activities of management through independent reviews performed by the auditors. Therefore, it is important that the auditors conduct their reviews with due care since their opinion on the reliability and credibility of financial statements prepared by management will be relied on by the shareholders for decision making. For this reason, audit quality is of critical importance to shareholders.

This study will examine quoted companies whose financial statements are audited by a Big 4 audit firm. These audits are guided by International Standards on Auditing (ISAs) set by the International Auditing and Assurance Standards Board (IAASB). According to International Standard on Auditing (ISA) 200, the purpose of a financial statements audit is to facilitate the auditor to provide an independent opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Quoted companies are required by the Companies Act Cap 486 section 159(1) to appoint an auditor. According to section 162(1) of the Act, the auditors are required to issue an audit report to the members (i.e. shareholders). The underlying objective of ISA 200 and Companies Act Cap 486 is to lend credibility to the financial statements presented by a company's management as agents to shareholders.

According to Power (1997), the issuance of an audit report provides important decision making information about the financial wellbeing of a company to stakeholders. Power (1997) argues that if the level of audit quality is adequate to require a company's management to issue credible and high quality financial information, then investors can use this reliable information to make more informed capital allocation decisions. Such decisions support the success of the investment environment by ensuring that capital is allocated to its most optimal uses. As a way for investors to determine whether an audit report on financial statements has compelled management to disclose credible and reliable financial information, Power (1997) contended that an audit report is a simple label of quality that can only possess value if there is social trust in the auditors that produced it. However, Sikka (2008) argued that auditors have been corrupted by an 'enterprise culture' that has negated any such social trust. Sikka (2009) continued his argument by noting that the global economic downturn of late 2008 posed questions about the role and value of audits in providing assurance on the reliability of financial statements.

According to the Corporate Governance Guidelines (CGG) (2002) provided by the Capital Markets Authority (CMA) in Kenya, the board of directors of a quoted company is required to set up an audit committee of at least three non-executive and independent

directors who report to the board. According to the guidelines, the AC is mandated to among other roles, review the quality of the external auditor's work. The CAQ in conjunction with the Independent Directors Council (IDC), Association of Audit Committee Members Inc. (AACMI), National Association of Corporate Directors (NACD), Corporate Board Member (an NYSE Euronext Company), Mutual Fund Directors Forum (MFDF) and Tapestry Networks developed a new tool in October 2012 to guide ACs in their annual review of their external auditor.

The proposition that each of the Big 4 firms performs higher quality audits in comparison to other audit firms has been a basis of studies in auditing and accounting (Deangelo, 2003). The theory of audit quality has regularly been linked by the association of a Big 4 audit firm (Bushman and Smith, 2003). Extant studies have examined whether the Big 4 audit firms, as a group, are quality-differentiated auditors compared to their non Big 4 counterparts (Davidson & Neu, 1993; Khurana & Raman, 2004; Levintis & Caramanis, 2005; Sun & Liu, 2010; Lennox & Pittman, 2011). However, there are a limited number of studies examining audit quality, on each individual Big 4 firm, one at a time. Following the collapse of Arthur Andersen in 2002, Deangelo (2003) suggests that a research on audit quality examining each Big 4 audit is necessary.

In Kenya, Deloitte and Touche has been accused of audit failure during their five year audit term at CMC Kenya. Specifically, the accusations mentioned the failure to disclose in the annual reports the company's subsidiary in South Sudan, not capturing interest payments for cars sold on credit, failure to recognize losses from CMC's assets that are damaged and abetting the booking of undelivered vehicle sales as revenues (Muchira, 2012). Before Deloitte and Touche assumed office, PricewaterhouseCoopers (PwC) had been providing audit services to CMC and did not raise an alert on the issues raised in the accusations. In 2006, PwC's audit practice was investigated by the ICPAK in relation to the collapse of Uchumi supermarkets. PwC issued unqualified audit reports even towards the collapse of the group of supermarkets (Muchira, 2012).

There is limited research on the audit quality difference among the Big 4 firms. As recently as 2009 in his research paper on the perceptions of the Big 4 brand as a label of quality, Fuerman notes that there is limited research comparing the audit quality differences among the Big 4 audit firms. Carlin, Finch and Laili (2009) also state that there is limited evidence in existing literature supporting the conclusion on whether quality differences exist among Big 4 firms.

In the 2009 research paper, Fuerman concluded that a Big 4 audit report should not necessarily be perceived by the public as a consistent label of quality. This conclusion draws research interest since prior research on audit quality between Big 4 and non-Big 4 audit firms has concluded that all Big 4 firms render high quality audit services homogenously.

In conclusion, quoted companies who have their financial statements audited by Big 4 firms are perceived to convey credible information regarding their financial performance and position. This is because the Big 4 label is associated with high quality. The investment community then makes investment decisions based on the audited financial statements. If a low quality audit is performed, there is a risk that investors may suffer investment losses. The limited research conducted so far on the audit quality differentials among Big 4 firms indicate that the homogenous audit quality perception may be inaccurate.

1.3 Problem Statement

Extant research on audit quality has concluded that Big 4 audit firms provide higher quality audits than non-Big 4 audit firms (Davidson & Neu, 1993; Khurana & Raman, 2004; Levintis & Caramanis, 2005; Sun & Liu, 2010; Lennox & Pittman, 2011). However, it is not clear whether audit quality is homogenous across all the Big 4 audit firms or whether quality differences exist among these firms. Majority of the extant research focus on the audit quality difference between Big 4 and non-Big 4 audit firms.

If actual audit quality differences exist while the perception is that audit quality is homogenous among the Big 4 firms, there is a risk that shareholders of the company

audited by the lowest ranking Big 4 firm may be placing undue trust and reliance on the opinion of that auditor. In the classical case of Enron Inc. and Arthur Andersen, shareholders of Enron must have had comfort in the audit opinions of Arthur Andersen, a Big 5 auditor at the time.

On the other hand, if no actual audit quality differences exist while the perception is that quality differences do exist, audit clients may be engaging in needless auditor selection and would be paying unnecessarily higher audit fees due to a perceived audit quality difference.

In Kenya, audit failure allegations against Deloitte & Touche and PwC in their audit of CMC Kenya and PwC in their audit of Uchumi supermarkets brings to question the level of audit quality of these Big 4 audit firms (Muchira, 2012).

According to Fuerman (2006) who used the number of litigation occurrences as a surrogate for audit quality, concluded that three Big 4 audit firms are higher quality auditors than Arthur Andersen, with the exception of Deloitte & Touche. Fuerman (2006) recommends further research to find out whether Deloitte & Touche is comparable, in terms of audit quality, to the other Big 4 audit firms. In contrast to Fuerman, Eisenberg and Macey (2004) who used the rate of financial statement restatements as an indicator of audit quality did not find in their study, a difference in audit quality between Arthur Andersen and the Big 4 audit firms. Fuerman (2007) conducted another research on the audit quality differences among Big 4 audit firms using the frequency of audit firms abetting frauds and frequency of audit firms appearing as defendants in legal suits and concluded that PricewaterhouseCoopers is the highest quality auditor among the Big 4 audit firms.

The research on audit quality among Big 4 firms conducted thus far is not conclusive on whether quality differences actually do exist. This research aims to identify whether audit quality differences exist among the Big 4 audit firms in Kenya using the new tool developed by CAQ in conjunction with other professional groups. The research will also

assess the extent to which ACs use the CAQ tool in evaluating the quality work of Big 4 audit firms. ACs play a key role in hiring and evaluating the quality of external auditors.

The motivation of this study is to assess whether all Big 4 firms have achieved a consistent level of audit quality. 55 out of 59 (93%) quoted companies in the Nairobi Securities Exchange are audited by a Big 4 firm (see table 2 in the appendix). The general public forms part of the shareholding in these firms. The uneducated are at a higher risk of making misinformed investment decisions as a result of unreliable financial information. The lower class may invest in these firms and lose the little savings they had. Therefore, auditors through their independent opinion are best placed to alert the investing public of any events that may jeopardize the public's investment. Therefore, high audit quality is essential to investment protection. An analysis of allegations of malpractices levelled against Big 4 audit firms globally in the last ten years indicate that all the Big 4 firms were at some point accused of negligence and incompetence that led to the audit client suffering losses and in extreme cases, winding up operations. Table 1 in the appendix summarizes names of companies and the related audit firm where allegations of audit malpractices were levelled against Big 4 audit firms globally in the last ten years.

It is important to critically study the audit quality of each Big 4 firm so that lower quality firms, if any, do not hide behind the veil of the highly regarded Big 4 label. ACs also need to perform robust evaluations of the external auditor to provide assurance that quality audits are performed.

1.4 Objectives of the Study

1. To examine audit quality differences exist among Big 4 audit firms in Kenya.
2. To assess the extent to which audit committees evaluate audit quality of Big 4 audit firms using the CAQ tool.

1.5 Research Questions

1. Are there audit quality differences among Big 4 audit firms?

2. To what extent do audit committees evaluate audit quality of Big 4 audit firms using the CAQ tool?

1.6 Scope of the Study

This study will examine audit quality differences among Big 4 audit firms using responses obtained from audit committee members of all clients of Big 4 audit firms quoted on the Nairobi Securities Exchange (NSE). This is because companies quoted on the NSE are regulated by the Companies Act Cap 486 to protect the investors from agency risks. Audit committees are mandated by the CGG (2002) provided by the CMA to review the quality of work of the external auditor.

1.7 Significance of the Study

The study will be significant to ACs in their review of current auditors to determine whether they are receiving quality audit services. ACs can adopt the CAQ tool used in this study's methodology in evaluating the quality of work of external auditors.

The Institute of Certified Public Accountants of Kenya (ICPAK) may borrow from the methodology used in this study to encourage AC members who are also members of the institute to use the CAQ tool in assessing their external auditors, whether Big 4 or non-Big 4 audit firms.

Audit firms may conduct periodic peer reviews to enhance quality of audit services rendered. Where the results of this study indicate that a certain Big 4 audit firm has higher audit quality, other audit firms could attempt to benchmark their practices against the practices of this higher quality audit firm.

This study will also be significant to future researchers in the studies on audit quality. By adding to the body of knowledge on audit quality, future researchers can make reference to this study in comparison to other studies on audit quality.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

The literature review begins by providing a definition of audit quality and identification of audit quality attributes that will be used to measure audit quality in this study. The next section will document the history of the Big 4 audit firms. It identifies the Big 4 audit firms and describes how they came into being. The theory underpinning this research is agency theory. The choice of the theory will be justified and the theory's relationship with audit quality will be discussed. An analysis of prior research on audit quality then follows. The audit quality variables used and the conclusions reached will be compared and contrasted and this will also serve to justify both the need for this research and the choice of audit quality attributes to be used. The latest findings of the Public Company Accounting Oversight Board (PCAOB) inspection reports will be reviewed. PCAOB conducts yearly inspections of all audit firms who issue more than one hundred audit reports in a year. Among these firms are all the Big 4 audit firms. The purpose of these inspections is to detect audit quality deficiencies of audits performed. An analysis of the inspection reports for all Big 4 audit firms will help to understand quality differentials if any, among the Big 4 audit firms.

2.2 Definition of Audit Quality and Audit Quality Attributes

Deangelo (1981) definition of audit quality has been extensively referred to in the studies on audit quality. Examples of such studies include Balsam et al. (2003), Davidson and Neu (1993), Colbert and Murray (1998), Krishnan (2003), Lennox and Pittman (2011). Deangelo defines audit quality as a function of the ability to detect and report errors and misstatements in financial statements. The ability to detect and report errors and misstatements depends on the attributes of the auditors performing the audit and characteristics of the audit firm in general. According to Graeme et al. (2011), audit team characteristics include quality of working relationships and communication between the audit team and client management, level of audit partner or audit manager involvement to

the audit, knowledge of the audit team, skills and experience of the audit team wholesomely and in relation to the clients' industry, ethical standards of the audit team and technical abilities of the auditors. Audit firm characteristics include audit tenure, audit firm size, provision of non-audit services, industry experience, litigation experience, auditor reputation, responsiveness to clients' needs, sceptical attitude of the firm and compliance with general audit standards. The tool developed by CAQ (2012) for ACs to evaluate the quality of work of external auditors covers three broad areas. These areas address similar audit quality attributes referred to by Graeme et al. These three broad areas of the CAQ tool are analyzed and presented in summary below:

1. Quality of services and sufficiency of resources provided by the auditor

As a first step, ACs review of the work of the external auditor involves evaluation of the service quality of the audits performed by the auditors at the field work stage and progressively in the financial year. Since audit quality to a large extent pegs on the calibre of staff performing the assignment, the AC needs to evaluate whether the participating auditors demonstrated the experience and skills required to address the company's significant risks relating to financial reporting and had access to the relevant experts and/or network practice resources during the assignment.

The audit team needs to have developed a robust risk assessment initially before beginning of the audit, which also includes a fraud risk assessment. During the assignment, the audit team needs to demonstrate a satisfactory comprehension of the organization's business model and operations, industry trends, and the effects of the economic environment on the organization. Additionally, the audit team should have captured any accounting and auditing developments that emanated from variations in the organization or its industry, or variations in technical requirements.

2. Communication and interaction with the auditor

Open and regular communication between the AC and the audit team is necessary for the AC to possess the information needed to meet its tasks relating to oversight on the organization's financial reporting processes. The standard of communications makes

available opportunities to evaluate the audit team's ability to deliver quality audits. While the audit team should communicate with the AC as material developments arise, the audit team should normally schedule sessions with the AC on a regular basis to make sure the AC has a full comprehension of the audit cycle (for example, audit planning, performance of interim and final procedures). The communication needs to concentrate on the significant technical issues that, in the audit team's assessment, introduce a material risk of financial statements misstatement, as well as addressing any queries of the AC.

3. Auditor independence, objectivity and professional scepticism

ACs should be well versed with the independence requirements for audit teams, including the requirement for audit teams to advise the AC of any instances that can be thought to adversely bear on independence.

The technical competence of the audit team on its own is not adequate to assure a high-quality audit. The audit team must also demonstrate sufficient of objectivity professional and scepticism. The AC's sessions with the audit team while performing field work avail opportunities to assess whether the auditor met objectivity, integrity, and professional scepticism requirements. For instance, the application of judgments and accounting estimates in the financial statements and required disclosures (such as impairment and fair value) continue to be a critical aspect of financial reporting. The audit team needs to be able to assess the assumptions and methods used and critique, where necessary, accounting policies and assumptions applied by management, including the transparency and completeness of the required disclosures.

A crucial aspect of assessing the audit team's professional scepticism and objectivity is for the AC to weigh the informative nature and frankness of responses to open-ended queries addressed to the auditors. Relevant topics include concerns on financial reporting posed by the organization's business model, the calibre of the finance management team, the soundness of the internal control structure, changes in key assumptions or accounting methods supporting crucial estimates, and the array of technical matters discussed with

management at the time of field work. The audit team should also be able to explain the steps followed and describe in summary the supporting evidence relied on to assess the significant judgments and estimates, and to conclude on whether the financial statements, taken as a whole, were fairly presented in accordance with International Financial Reporting Standards (IFRSs).

2.3 History of the Big 4 Audit Firms

According to Stuart (2013), the Big 4 audit firms are the four largest international audit firms worldwide. They perform the majority of audits for public companies and as a result lock out non-Big 4 audit firms in auditing large companies in the world. In Kenya, the Big 4 audit firms perform financial statements audits for 55 out of the 59 companies quoted on the NSE. The Big 4 was initially recognized as the Big 8 and the number reduced to six and later to five by a number of mergers over time. The Big 5 reduced to the Big 4 following the collapse of Arthur Andersen in 2002 after its involvement in the Enron fiasco. Currently, the Big 4 audit firms are Ernst & Young, PricewaterhouseCoopers, Deloitte and Touche and KPMG.

A Big 4 firm is not a single firm. Each firm is an association of firms, administered independently, and under contracts with other member firms in the network to share quality standards, brand and a common name. Each association has set up a company to coordinate the association's activities. For instance, for KPMG, the coordinating company is Swiss, and in other cases (Deloitte Touche Tohmatsu, PricewaterhouseCoopers and Ernst & Young), the coordinating company is based in UK. These coordinating companies do not engage in auditing or accountancy and do not influence the constituent firms. In most cases, each constituent firm practices in a one country, and is set up to adhere with the regulations in that country.

2.3.1 Mergers of the Big Audit Firms

From 1989, agreements to merge and one infamous audit failure involving Arthur Andersen reduced the number of Big N audit firms to four from eight.

Big 8

The audit firms were referred to as the Big 8 for the better part of the 20th century, depicting the global dominance of the Big audit firms listed below:

1. Ernst & Whinney (until 1979 Ernst & Ernst in the US and Whinney Murray in the UK)
2. Touche Ross
3. Arthur Young & Co.
4. Peat Marwick Mitchell (later Peat Marwick, then KPMG)
5. Price Waterhouse
6. Coopers & Lybrand (until 1973 Cooper Brothers in the UK and Lybrand, Ross Bros., & Montgomery in the US)
7. Deloitte Haskins & Sells (until 1978 Haskins & Sells in the US and Deloitte & Co. in the UK)
8. Arthur Andersen (collapsed in 2002 for its involvement in the Enron scandal.)

The Big 8 came to being from mergers created between US and British accounting firms in the 19th century. Price Waterhouse was a UK accountancy firm which began practicing in the US in 1890 and later set up a separate US partnership. The UK and US Peat Marwick Mitchell firms began using a common name in 1925. Other firms used different names for domestic business, and did not begin using common names until much later. Touche Ross in 1960, Arthur Young (at first Arthur Young, McLelland Moores) in 1968, Coopers & Lybrand in 1973, Deloitte Haskins & Sells in 1978 and Ernst & Whinney in 1979.

The accountancy firms' initial global expansion was pushed by the needs of British and US based multinational companies for international service. The firms spread out by forming local partnerships or by forming alliances with local firms.

Arthur Andersen had a different history. The firm originated in the US and spread out globally by establishing its own offices in other markets, including the UK.

In the 1980s the Big 8, each now with international branding, used modern marketing and expanded rapidly. The firms merged with many smaller firms. One of the largest of these mergers was in 1987, when Peat Marwick merged with the Klynveld Main Goerdeler (KMG) group to become KPMG Peat Marwick, later known simply as KPMG.

Big 6

The pursuit of dominance among these Big audit firms stepped up and the Big 8 reduced to the *Big 6* in 1989 when Ernst & Whinney merged with Arthur Young to form Ernst & Young in June, and Deloitte, Haskins & Sells merged with Touche Ross to form Deloitte & Touche in August of the same year.

In the UK, the local firm of Deloitte, Haskins & Sells merged instead with Coopers & Lybrand. For some years after the merger, the merged firm was called Coopers & Lybrand Deloitte and the local firm of Touche Ross retained its original name. In the mid 1990s however, both UK firms changed their names to match those of their respective global firms. On the other hand, in Australia the local firm of Touche Ross merged instead with KPMG. It is for these reasons that the Deloitte & Touche international organization was known as DRT International (later DTT International), to avoid use of names which would have been ambiguous as well as contested in certain markets. Elsewhere, the local firm in Malaysia merged with Arthur Andersen.

Big 5

The Big 6 reduced to the Big 5 when Price Waterhouse merged with Coopers & Lybrand to form PricewaterhouseCoopers in July 1998.

Big 4

The fall of Enron and the resulting investigation triggered close reviews of their financial reporting process which Arthur Andersen had audited. Arthur Andersen finally was found guilty for obstruction of justice for destroying records regarding the audit in the 2001 Enron fiasco. The subsequent conviction meant the demise of Arthur Andersen. Majority of its country practices worldwide were acquired by the current Big 4 firms, notably

Deloitte & Touche in the UK, Canada, Spain and Brazil, Ernst & Young globally, and PricewaterhouseCoopers (now known as PwC) in China and Hong Kong.

The Big 4 audit firms (PricewaterhouseCoopers, Ernst & Young, KPMG and Deloitte and Touche) are at times known as the "Final Four" because of the strong belief of a low likelihood that regulators will allow further mergers of the accounting industry and that non Big 4 audit firms will not be able to compete with the Big 4, as there is a market perception that they are not reliable as advisors or auditors to the largest companies.

2.4 Relationship between Agency Theory and Audit Quality

According to the agency theory, an agency relationship exists between shareholders and managers of a company. Jensen and Meckling (1976) define an agency relationship as a binding agreement in which one party (the principal) engages another party (the agent) to act on their behalf. The principal delegates decision making responsibilities to the agent. Shareholders of a company being the principals, delegate the administration of their company to a management team, who are the agents in this relationship.

Jensen and Meckling (1976) argue that if both shareholders and management are utility maximizers, it is reasonable to expect that the agent will not always act in the best interest of the principal. They describe this divergence is described as moral hazard and adverse selection. Moral hazard is a situation where the agent will have a tendency to take risks because the costs that could incur will be felt principal. Adverse selection occurs when, due to information asymmetry, the agent makes decisions beneficial to the self but to the detriment of the principal. To mitigate the risks of moral hazard and adverse selection, Jensen and Meckling (1976) state that the principal has to incur monitoring costs since it is generally impossible for the principal at zero cost, to ensure that the agent will make optimal decisions from the principal's viewpoint. These monitoring costs may be in the form of audits fees. To assure that no material moral hazards and adverse selections risks such as earnings management exist, periodic audits on the financial performance and position reported by management are performed. The audit report is addressed to the shareholders. The opinion issued in the audit report may

then be relied on by the investment community. It is therefore critical that high quality audits are performed so that material misstatements and errors are disclosed and an accurate audit opinion issued.

Section 147 of the Companies Act requires the company to keep proper books of accounts and other statutory records. This is to ensure that decisions and actions of directors will be properly documented so that the shareholders can inspect the company records at any time they wish. Section 159 of the Companies Act requires the directors to prepare accounts of their financial stewardship and send them to all the shareholders so that they can ascertain the operation and financial position of their company. Section 159 further requires the directors to call an Annual General Meeting (AGM) at which the company accounts are laid before the shareholders as a group. This ensures that the shareholders can use their powers to oversee operation of their company by, for instance, questioning the directors on matters relating to management of the company.

A problem here is that these company accounts and reports the shareholders use to evaluate the financial stewardship of directors and which can be used to discipline or reward the directors are prepared by the directors themselves. In any case, any performance based bonus is likely to be calculated from figures published in the company accounts. This can tempt the directors to manipulate figures which are published in the accounts. Thus, the company accounts prepared by the directors may lack credibility and hence section 159 of the Company Act requires that every company must have an auditor regardless of the wish of the shareholders or directors. The shareholders receive financial accounts and other information from the directors and therefore need assurance regarding the quality of the information. An individual shareholder should inspect the company accounts to establish their credibility if he so wishes but due to lack of time and skill, an audit as a monitoring tool provides a solution to the agency problem facing the shareholders.

It is unlikely that financial statements would give a true and fair view when appropriate IFRS are departed from. Auditors can on their part refer to the departure in their audit report and clearly indicate whether or not they concur with the departure.

2.5 Prior Research on Audit Quality

Extant research on audit quality has concluded that Big 4 audit firms provide higher quality audits compared to their non-Big 4 counterparts (Davidson & Neu, 1993; Khurana & Raman, 2004; Levintis & Caramanis, 2005; Sun & Liu, 2010; Lennox & Pittman, 2011). This conclusion implies that Big 4 firms in general provide high quality audits homogenously.

An analysis of the Big 4 audit firm scandals in the last ten years casts doubt on the validity of this conclusion (see table 1 in the appendix for a summary of the companies involved in Big 4 audit failures allegations in the past ten years). Arthur Andersen, a Big 5 audit firm, exited the audit services market in August 2002 following the collapse of Enron. This exit indicates that Arthur Andersen a Big 5 audit firm at the time provided lower audit quality compared to its peers. Fuerman (2006) comparing the audit quality of the current Big 4 audit firms to Arthur Andersen concluded that indeed Arthur Andersen was a lower quality audit firm than three of the Big 4 audit firms. The exception was Deloitte & Touche. Fuerman (2003) also concluded though less formally that PricewaterhouseCoopers provided the highest audit quality among the Big 4 audit firms.

Carlin, Finch & Laili (2009) explored the widely held theme that Big 4 audit firms are homogenous in providing higher audit quality than non-Big 4 audit firms. They acknowledged that there is limited evidence in existing research supporting the conclusion of quality differentials between Big 4 firms, with the exception that the collapse of Arthur Anderson brings to question this proposition that Big 'N' audit firms are associated with higher audit quality. The results of Carlin, Finch & Laili (2009) study found deficiencies in the audits performed by Big 4 auditors in Malaysia to comply with elements of the FRS 136 disclosure framework in relation to goodwill impairment

testing. This finding casts doubt on the high quality perception attributed to Big 4 audit firms.

Deangelo (1981) developed a theory that audit firm size is a measure of audit quality. Deangelo (1981) postulated that large audit firms have a large client portfolio and that no one client accounts for a significant portion of the audit firm's revenue. Therefore, a large audit firm would be more independent in the audit of any one client since it would not want to risk eroding its reputational capital. If this theory was true, the expectation would be that if all Big 4 audit firms provide homogenous audit quality, they would hold the same level of reputational capital.

Watkins (2004) defined audit quality as an attribute of auditor monitoring strength and auditor perception. Watkins concurred with Deangelo's definition of audit quality by arguing that the two attributes namely professional competence and independence determine auditor monitoring strength and that the perception of these two attributes determines auditor reputation. Watkins concluded his argument by stating that the perception of these two attributes is as significant as their reality in achieving audit quality. For all Big 4 audit firms to have homogenous audit quality, they would have to have the same level of professional competence and independence.

Palmrose (1988) postulated that audit failures can be regarded as red flags of the level of actual professional competence and auditor monitoring strengths. An analysis of legal cases as a measure of audit quality among the Big 8 (at the time) indicated no significant audit quality differences.

In his research, Moizer (1997) used audit fee as a measure of audit quality and found that PricewaterhouseCoopers was the highest quality auditor. The hypothesis used by Moizer (1997) was that higher quality audit firms charge higher audit fees.

Gilbertson and Avila (1999) reviewed legal cases against the Big 4 firms and found that Ernst and Young was least involved in legal suits and would therefore be identified as the highest quality audit firm on this basis.

On the contrary, Eisenberg and Macey (2004) analyzed the financial statement restatements of Arthur Andersen and compared them to the other Big 4 firms and found no significant differences in audit quality. A similar conclusion was arrived at by Kumar and Lim (2006). They compared the earnings response coefficients of Andersen's clients to the clients of other Big 4 firms and found no significant differences.

Percy (2006) states that rivals of PricewaterhouseCoopers (PwC) disputed claims made by PwC's chairman Kieran Poynter that a quality gap is opening up between the firm and the rest of the Big 4. Poynter made the claims as he revealed that PwC's annual fee income had increased by 11% to almost £2bn. He stated the firm's ambition was to become recognised that it is different on grounds of quality. In response to these remarks, John Griffith-Jones, Senior Partner at KPMG stated that Poynter did not have a basis for arguing that PwC's audit quality is higher. John Griffith-Jones added that he suspected PwC would be the slowest growing of the Big 4 in that year. To contribute to the debate, Deloitte's chief executive John Connolly commented that the unrelenting pursuit of the highest quality in professional work remained one of the cornerstones in Deloitte's continuing success. Ernst & Young declined to comment. This audit quality spat among the Big 4 indicates that they compete on quality and therefore, quality differences may exist. While each Big 4 chief executive would claim that their firm provides the highest quality audit, research into audit quality differences among the Big 4 firms would serve to set the record straight and do away with the confusion brought about by such spats.

Francis and Yu (2009) found a systematic association between Big 4 office size and audit outcomes consistent with larger offices producing higher quality audits. This means that Big 4 audit quality is higher in countries where they have larger offices. For instance, PwC may have a larger office in the US and UK compared to Kenya. In those countries, PwC may have been found to be the highest quality auditor. In Kenya, it may not be

obvious that PwC would be ranked as the highest quality auditor according to the conclusion reached by Francis and Yu (2009). This then necessitates independent research into the audit quality differences among Big 4 audit firms since the research conclusions in foreign audit services markets may not readily apply in the Kenyan audit services market.

Lennox and Pittman (2011) describe two sets of arguments to highlight Big 4 firm attributes that contribute to higher quality. The first is the screening argument; that Big 4 audit firms are more careful at scrutinizing the clients that have a higher likelihood to commit fraud. The second is the selection argument; that clients planning to commit fraud have a lower likelihood of appointing Big 4 audit firms. The findings of Lennox and Pittman (2011) were that Big 4 firms have a higher likelihood of quitting from clients that engage in fraud, which fails to agree with the screening argument. Additionally, the outcomes do not suggest that fraud clients have a lower likelihood of switching to Big 4 firms, which fails to agree with the selection argument. They conclude that frauds committed by clients of Big 4 firms are an artefact of company size; that large companies have an increasing tendency to resort to accounting fraud. This argument is an escapist attempt from owning up for low audit quality by Big 4 firms.

Other justifications have been proposed to support the conception that the Big 4 audit firms perform high quality audits. In the process, a number of varying attributes of audit quality have been suggested. The presence of a number of justifications is perhaps unavoidable, because a requirement of arriving at informed conclusions on audit quality is to review the audit work papers and to interrogate the auditors who performed the audit (Moizer, 1997). This may not be practical due to the work product confidentiality maintained by the auditors.

In addition to service quality as an element of the competency of the provider, Deangelo (1981) proceeded to incorporate auditor independence which the researcher argued that over time, had become a matter of debate since audit fee paid to the auditor is influenced by the auditee's management. Deangelo (1981) debated that this was the reason the Big 4

audit firms are superior quality auditors compared to non-Big 4 firms. Big 4 firms have more financial independence. A single client is financially inconsequential to a Big 4 firm, in comparison to the financial importance of maintaining a brand for independence and by extension audit quality. This, on the other hand, is not the case with non Big 4 audit firms. Deangelo (1981) theory is persuasive, on condition that an audit firm is only presumed to be the only player. In reality, the audit services market is competitive and characterized by a number of audit firms. Additionally, inflexibly viewing an audit firm as a one player is challenging since the firm's willingly pass the blame to particular audit staff in the event that the existence of the entire audit firm is at risk.

A similar finding in the audit fee research is that the Big 4 audit firms receive a higher fee to conduct an audit compared to non-Big 4 firms. PwC was found to have received the highest fee to conduct an audit compared to other large audit firms (Moizer 1997). These researches demonstrate differences in audit quality, presuming that an auditor that receives higher fees conducts higher quality audits. However, there are other rationales for differences in audit fee such as, industry monopoly, reputation and the insurance hypothesis, that is, deep pockets if as a result, audit failure comes to light and investors decide to sue the auditor (Lennox, 1999).

The outcomes of the initial public offering (IPO) researches vary with moderation than the audit fee studies. However, they share outcomes with the audit fee studies. Big 4 audit firms are normally linked with lower IPO under pricing (the variance between first open market bid price and IPO's offer value), the use of reputed brokers, and low brokerage fees (Chang et. Al, 2008).

There have been several researches of the securities market responses to changes in audit firms. The outcomes of these researches vary moderately compared to the IPO researches. However, changes to a Big 4 auditor from a non-Big 4 auditor was normally viewed as normal or sometimes positively by the securities market. On the other hand, changes to a non-Big 4 auditor from a Big 4 auditor was usually viewed adversely by the securities market (Moizer, 1997).

Teoh and Wong (1993) examined audit quality based on the earnings response coefficient (ERC). The ERC is a valuation of the range to which earnings data that is new is capitalized (since it is viewed as being trustworthy) in the securities value. Teoh and Wong (1993) concluded that the ERC for Big 4 clients were higher compared to that of the non-Big audit firms. This implies, presuming that an ERC is a correct valuation of the range to which earnings data that is new is capitalized in the share value, that the Big 4 firms are higher quality auditors.

Earnings management studies support the proposition that Big 4 clients are have a lower likelihood of engaging in the practice earnings management than non-Big 4 firm clients. DeFond and Jiambalvo (1991) argued that the Big 4 had a lower likelihood of being the auditors of a client that had to restate their audited annual financial statements. Becker, et al. (1998) concluded that income-increasing discretionary accruals were higher for non-Big 4 firm clients, as a fraction of asset totals, than for Big 4 firm clients. Francis, et al. (1999) concluded that earnings management, depicted in discretionary accruals, were higher among non-Big 4 firm clients than Big 4 firm clients. Frankel, et al. (2002) argued that the Big 4 firms had a lower likelihood of being the auditors of a client that was involved in earnings management.

Big 4 firms had legal cases at a lower occurrence rate per projected audit conducted compared to non-Big 4 firms (Palmrose, 1988). As far as this can be related to higher audit quality implies that Big 4 audit firms are higher quality auditors. In legal cases where the auditor appeared as a defendant, Big 4 audit firms appeared as defendants in lower proportions than non-Big 4 auditors according to Fuerman (2000).

According to Fuerman (2003), prior research on audit quality evaluated the Big 4 firms as a group since the research set up was deficient in terms of statistical ability or could not allow each Big 4 firm to be analyzed one at a time.

It would be impractical for the purpose of this study, to replicate and extend the foregoing studies in order to answer the question of audit quality differentiation among the Big 4

firms in Kenya. Therefore a realistic research design has been constructed with the foregoing findings and conclusions taken into consideration.

2.6 Public Company Accounting Oversight Board (PCAOB) Inspection Reports

The PCAOB scrutinizes all registered audit firms that periodically issue audit reports for companies pursuant to the Sarbanes Oxley Act (2002). The scrutiny is planned to highlight and remediate audit deficiencies and weaknesses relating to how an audit practice performs audit work.

Audit firms that provide audit reports on more than 100 companies are scrutinized yearly. Among these number of firms is the Big 4 audit firms. Other registered audit firms that periodically provide audit reports on companies are, generally, scrutinized approximately once in a three year cycle.

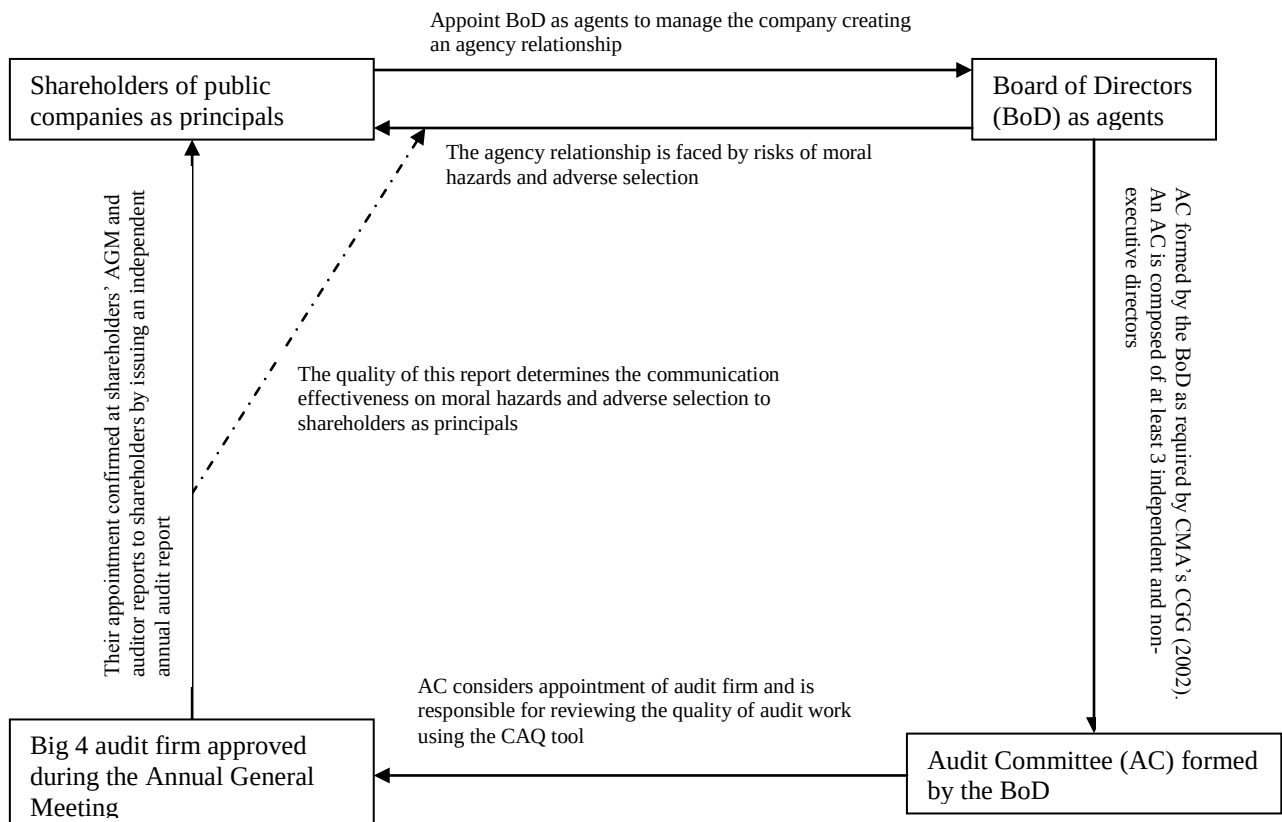
The PCAOB prepares an inspection report on each scrutiny performed, and a section of every report is made publicly accessible after being issued. Most reports contain non-public information that could detail such things as, narratives of probable defects in a practice's system of quality control. Those quality control critiques remain non-public on condition that the practice remediates them to the PCAOB's satisfaction in one year from the date of the report. If a practice does not satisfactorily remediate some of the quality concerns in one year, the section of the report describing the specific critiques is made publicly accessible.

For the purpose of this study, summary findings of the latest available inspection reports made public on all the Big 4 audit firms in the United States were analyzed. The findings of these inspection reports indicate systematic quality control deficiencies in the performance of some of the audits by all Big 4 audit firms. This indicates that the Big 4 label of quality needs to be reviewed in detail in order to demystify the belief that all Big 4 audit firms provide homogenous high quality audits.

2.7 Conclusion

The literature review above has discussed the history of the Big 4 audit firms describing how through firm mergers and industry regulation, the group has come to be. The definition of audit quality and a highlight of audit quality attributes then followed. For the purpose of this study, the tool developed by CAQ and responses obtained from ACs members of quoted companies in the NSE will be used to address the objectives of this study. Agency theory as the underpinning theory of this study has been reviewed and conclusions from prior studies on audit quality among the Big 4 have been compared, contrasted and critiqued. The latest PCAOB inspection reports have reviewed. They indicate various shortfalls in the quality of audits among all the Big 4 audit firms. Based on the importance of audit quality in mitigating the agency problem, the inconclusive aspect of prior studies on audit quality among the Big 4 firms and the results of the PCAOB inspection reports, this study aims to add onto the literature on the audit quality among Big 4 firms specifically in the Kenya audit services market.

To achieve the objectives of this study, the following conceptual framework will be used.



CHAPTER 3

RESEARCH METHODOLOGY

3.1. Introduction

This chapter begins by describing the research design. The population is then defined and variables to be used in the study are identified. The data collection method and justification for the method chosen is then discussed. A description of the data analysis methodology is provided and how the results will address the objectives of the study follows. Research quality describing the validity, reliability and objectivity of the study is also presented. The chapter concludes by describing the ethical considerations and limitations of the study respectively.

3.2 Research Design

Quantitative research methodology will be used in this study. The purpose of quantitative research is to quantify data and generalize results from a sample to the population of interest. The research will take on a confirmatory and cross sectional research design. Prior research on audit quality has been based on the premise that Big 4 audit firms provide homogenous audit quality (Davidson & Neu, 1993; Khurana & Raman, 2004; Levintis & Caramanis, 2005; Sun & Liu, 2010; Lennox & Pittman, 2011). Nevertheless, allegations of malpractices against the Big 4 audit firms (see table 1 in the appendix) and findings of PCAOB inspections cast doubt on this premise. This study will examine audit quality differences among Big 4 audit firms in Kenya at this point in time. The study will also examine the extent to which ACs review the work of external auditors using the CAQ tool. ACs are required by the CGG issued by the CMA to review the quality of work of external auditors.

3.3 Population Selection

All Big 4 audit firms will be the subject of this study. 55 out of 59 companies quoted on the NSE are audited by a Big 4 audit firm. The chair of the ACs of all companies quoted in the NSE and whose financial statements are audited by a Big 4 audit firm will be the

respondents in this study since they are likely to provide more objective and knowledgeable responses. An AC is comprised of at least three non-executive and independent directors who report to the board and one of their roles is to review the quality of work of the external auditors.

3.4 Variables Definition

The CAQ's tool for ACs identifies audit quality review elements that ACs should check when evaluating the quality of work of external auditors. The tool specifies AC review work to cover three areas namely: quality of services and sufficiency of resources provided by the auditor, communication and interaction with the auditor, and auditor independence, objectivity and professional scepticism.

3.5 Data Collection

Data based on the questions from the CAQ tool will be collected using a questionnaire (see appendix) sent to the chair of ACs of the companies quoted on the NSE. This is because audit committee members review the quality of work of external auditors and would therefore be best place to assess audit quality. Questionnaires will be able to reach a large number of respondents quickly, easily and efficiently and afford the respondents anonymity and privacy. The questionnaire will be designed in a way such that the respondents will be required to evaluate audit quality by indicating scores along a 5 point likert scale. The 5 point likert scale will persuade indecisive respondents to make a decision and will also provide rigour during data analysis.

3.6 Data Analysis and Measurement

In presenting the findings, percentages will be used to indicate what proportion of the respondents selected each likert scale choice for every question. In determining the total score for each questionnaire, the likert scale choices will be weighed as follows (weights in brackets): Strongly Agree (4), Agree (3), Disagree (2), Strongly Disagree (1). The fifth

choice will either be Not Applicable or Not Sure depending on the structure of the questionnaire.

To address objective 1, responses sought in the questionnaire and measured using a likert scale will be analyzed using the one-way ANOVA (Analysis of Variance) method. A One-Way ANOVA is a way to test the equality of three or more means at one time by using variances. To perform a one-way ANOVA, the number of samples, the sample means, the sample variances, and the sample sizes are required. In this case, the mean value of responses for all Big 4 audit firms will be analyzed using one-way ANOVA. If the 'Sig value' from the ANOVA results is less than or equal to 0.05, then there is insignificant difference among the mean scores meaning no significant audit quality differences exist. SPSS software will be used to perform ANOVA.

To address objective 2, specific questions will include a 'Not Sure' response. ACs are required to address the requirements of the CAQ tool when evaluating quality of external auditors. Results will be presented in percentages representing the proportion of respondents who were not sure whether the external auditor met the quality evaluation criteria.

3.7 Research Quality

According to Hannes et. al. (2011), external validity evaluates whether research findings are transferable to other specific settings. Evaluation techniques include providing details of the study participants to enable readers to evaluate for which target groups the study provides valuable information, providing contextual background information, demographics and the provision of thick description about both the sending and the receiving context. This research possesses external validity since the unit of the study being the Big 4 audit firms have been identified. Additionally, Table 2 in the Appendix has identified the public companies audited by the Big 4 audit firms. The target respondents have also been identified as the chair of the AC of the public companies. As a result, independent studies on audit quality can make reference to this research to the extent that those studies refer to ACs, public companies and the Big 4 audit firms.

Hannes et. al. (2011) also states that research reliability evaluates whether the process of research is logical, traceable and clearly documented, particularly on the methods chosen and the decisions made by the researchers. This research is reliable since the subject of audit quality has been linked to agency theory and justifications have been presented as to why audit quality directly affects the monitoring of agency conflicts. ACs have been selected as respondents in this research since they have the responsibility of reviewing the quality of work of the external auditor and are therefore well placed to review audit quality.

3.8 Ethical Considerations

The study will seek responses from audit committee members of clients of Big 4 audit firms to assess audit quality of these firms. There is the risk that the results of the study if made publicly available may harm the reputation of these firms. A caveat has been given to the respondents to restrict circulation of the final results since this study is for academic purposes and is not intended to be relied on as professional advice.

Responses will be sought from respondents without offering any inducement. This approach will assist in obtaining objective responses. The responses will be analyzed in their original form to avoid interpretation bias. No responses will be obtained without the prior consent of the target respondents.

All the data used for analysis will be the result of data collection methods described above. Analysis will not be based on falsified or plagiarized data.

3.9 Limitations of the Study

No common methodology has been agreed on in regard to assessment of audit quality. Many proxies of measuring audit quality have been used in extant research yielding different study findings. The methodology used in the study while relevant, objective and meaningful cannot be said to be the most superior.

The intervals between points on the likert scale may not present equal changes in attitude for all respondents (that is, the differences between “strongly agree” and “agree” may be slight for one respondent and great for another).

There is a risk of response bias if the respondents were previous Big 4 firm alumni. This means that AC members who are alumni of the Big 4 firm being studied may give inflated ratings on the firm's audit quality practice.

CHAPTER FOUR

PRESENTATION OF RESEARCH FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter covers sections relating to the response rate, quality of services and sufficiency of resources provided by the auditor, communication and interaction with the auditor and auditor independence, objectivity and professional scepticism. Other than the section covering the response rate, the other three sections are guided by the framework provided by CAQ. This chapter also discusses the results of ANOVA analysis in addressing the first objective and percentage analysis in addressing the second objective. The results will be analyzed and presented per the three broad categories of the CAQ tool.

4.2 Response Rate

The study targeted responses from Audit Committee members of all companies quoted on the NSE and whose financial statements are audited by a Big 4 audit firm. 55 out of 59 companies quoted on the NSE are audited by a Big 4 firm. Out of the 55 companies, responses were obtained from 46 companies. This represents an 84% response rate. Using the Chi Square test for the goodness of fit, the observed versus expected observations are comparable.

Table 4.1 below illustrates the response rate and Chi Square test results.

Table 4.1: Response rate per Big 4 audit firm

Big 4 Audit Firm	Observed responses (O)	Percent	Expected responses (E)	(O-E) ² /E	Result for p-Value (3df)
Ernst & Young	9	20	10	0.1	Value less than 2.37 at 3df is Insignificant
Pricewaterhouse Coopers	11	24	14	0.64	
KPMG	7	15	8	0.13	
Deloitte & Touche	19	41	23	0.70	
Total	46	100		1.56	

4.3 Quality of Services and Sufficiency of Resources Provided by the Auditor

The research aimed to evaluate the quality of services and sufficiency of resources provided by the auditor. From the findings, it is clear that 31% of the respondents strongly agree that the audit partner and audit teams had the necessary knowledge and skills relevant to the company, the wider industry and technical accounting and audit skills to meet the company's audit requirements. On the other hand, 69% of the respondents agree that the audit partner and audit teams had the necessary knowledge and skills relevant to the company, the wider industry and technical accounting and audit skills to meet the company's audit requirements. This implies that the auditors were competent as assessed by the ACs to perform a quality audits.

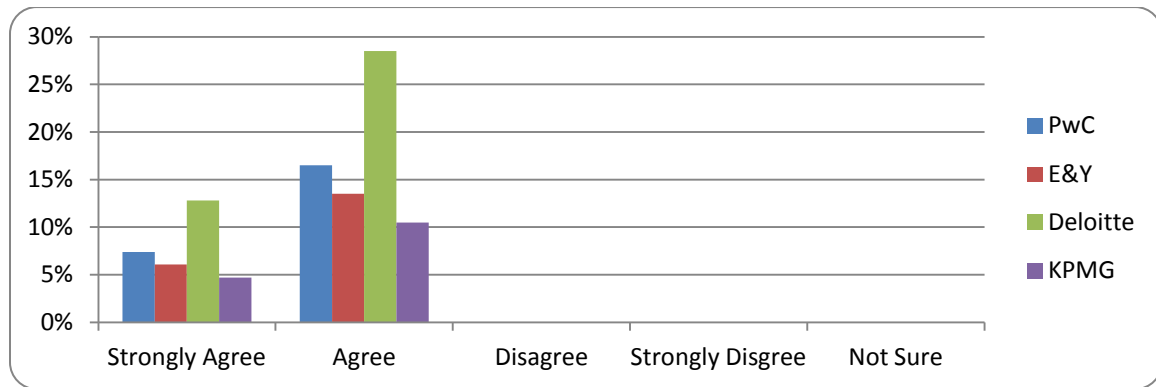


FIGURE 4.1: THE AUDITOR HAD THE NECESSARY KNOWLEDGE AND SKILLS TO MEET OUR AUDIT REQUIREMENTS

The research planned to establish whether the appropriate resources were assigned to perform the audit. The findings indicate that 46% of the respondents agreed that the audit firm dedicated the appropriate resources while 33% of the respondents strongly agreed that their external auditor dedicated the appropriate resources to the audit. On the other hand, the study findings indicate that 13% and 8% of the respondents disagree and strongly disagree respectively that their external auditor dedicated the appropriate resources to the audit. This implies that a majority of audit firms (up to 79%) constitute audit teams that will perform timely quality audits.

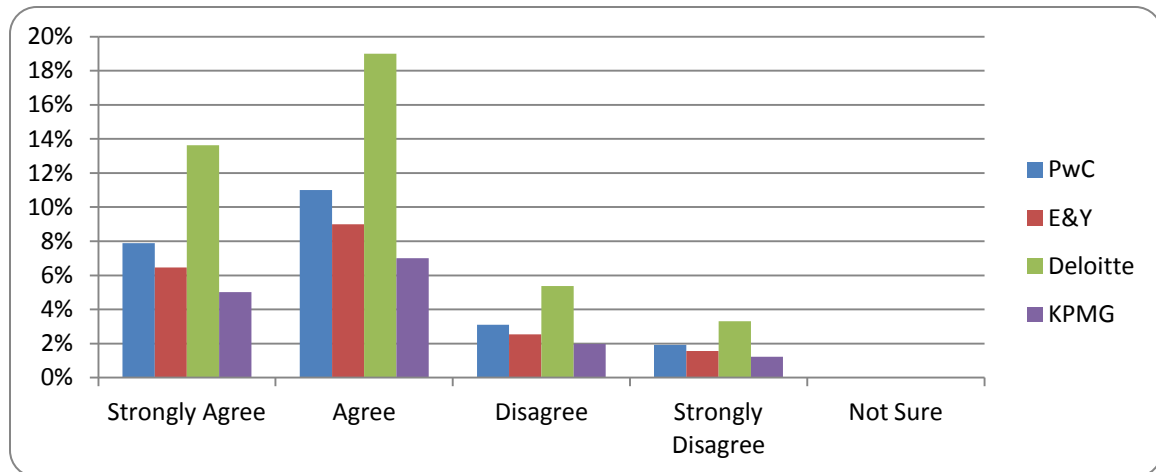


FIGURE 4.2: THE APPROPRIATE RESOURCES WERE ASSIGNED TO PERFORM THE AUDIT

The research inquired on whether the auditors requested feedback on the quality of the audit performed. The findings indicate that 44% of the respondents agree that the auditor requested feedback on the quality of the audit. This was followed by those who strongly agree at 23% that their auditors sought feedback while 15% of the respondents strongly disagreed that their external auditors sought the feedback on the quality of the audit performed. This means that only a minority of the audit firms fail seek to improve on the quality of their work in an attempt to meet their clients audit needs.

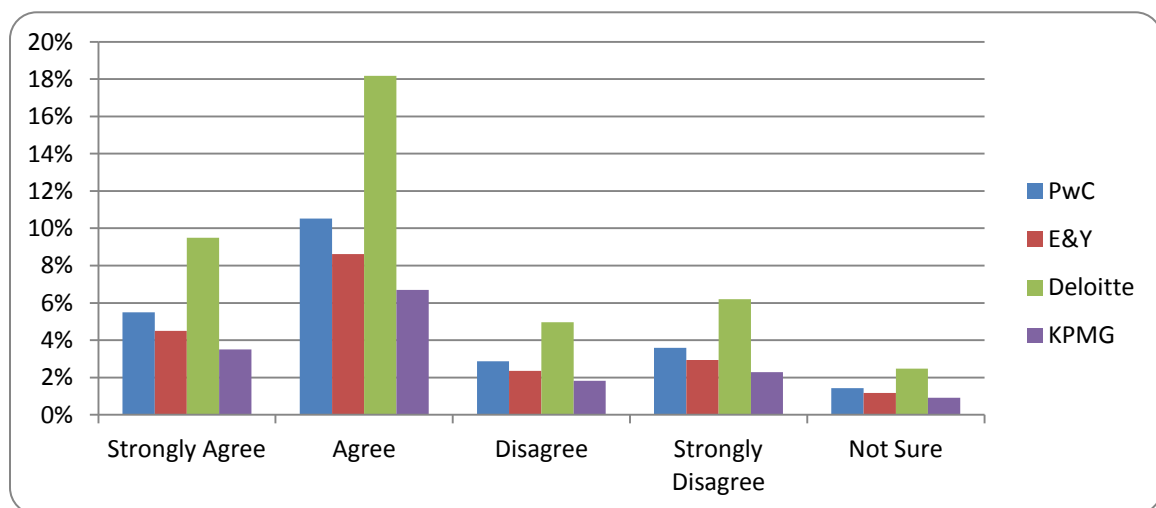


FIGURE 4.3: THE AUDITORS REQUESTED FEEDBACK ON THE QUALITY OF THE AUDIT PERFORMED

The study intended to establish whether those who requested feedback on the quality of audit performed responded constructively to feedback given. The findings indicate that 46% of the respondents agree that the auditors responded constructively to feedback while 27% of the respondents strongly agreed that their auditors responded constructively to feedback. 19% of the respondents disagreed that their auditors responded constructively to feedback while 6% of the respondents were not sure of how the auditors responded to feedback. 2% of the respondents strongly disagreed that their auditor responded constructively to feedback. This implies that a majority of the auditors (up to 73%) utilized the requested feedback to improve their audit services to the client.

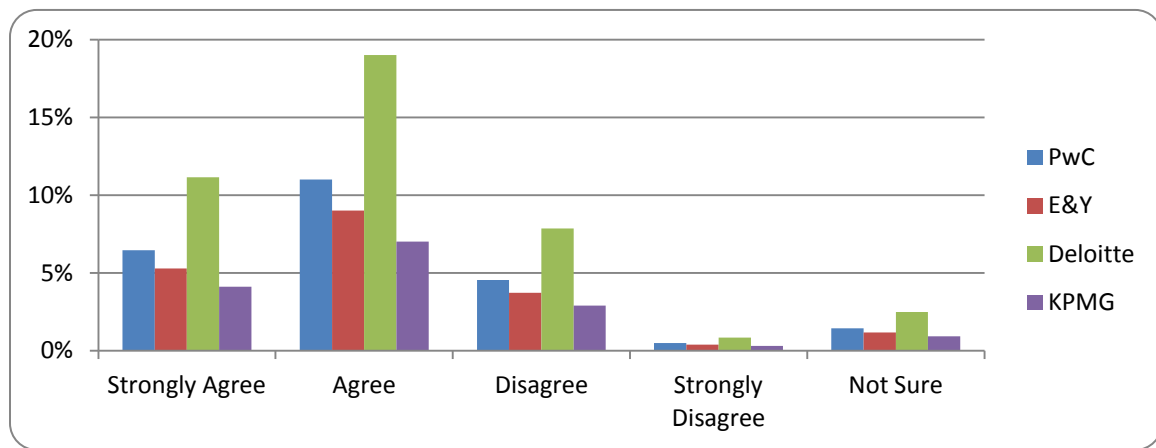


FIGURE 4.4: THE AUDITORS RESPONDED CONSTRUCTIVELY TO FEEDBACK GIVEN ON THE QUALITY OF AUDIT PERFORMED

The respondents were asked whether the audit partner had access to the AC and management. From the findings, it is indicated that 63% of the respondents agree that the audit partner had access to the AC and management while 19% strongly agree that this was the case. The study findings also indicate that 6% of the respondents each disagreed, strongly disagreed and some were not sure whether the lead engagement partner had access to the AC and management. This means that the majority of auditors interacted with the AC and company management to ensure that an effective and quality audit was performed. However, a minority of the auditors was assessed as not having adequately interacted with the AC and company management to ensure an effective audit was

performed. Though this is a small percentage, limited access to the AC and company management bears adversely on audit quality.

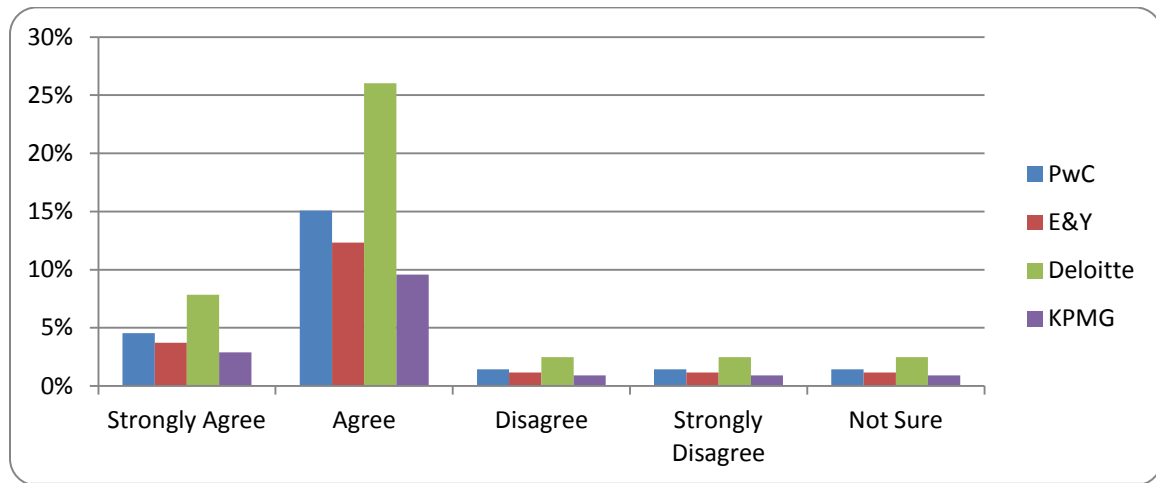


FIGURE 4.5: THE AUDIT PARTNER HAD ACCESS TO THE AC AND MANAGEMENT

The research sought to find out whether the lead audit partner devoted adequate attention and leadership to the engagement. The study findings indicate that 48% agree while 25% strongly agree that the audit partner devoted adequate attention and leadership to the engagement. This was as opposed to 15% of the respondents who disagreed, 8% who were not sure and 4% who strongly disagreed that the audit partner devoted adequate attention and leadership to the engagement. Though a majority of auditors were found to have devoted adequate attention and leadership to the engagement, the minority exhibited a lack of devotion which adversely impacts on audit quality.

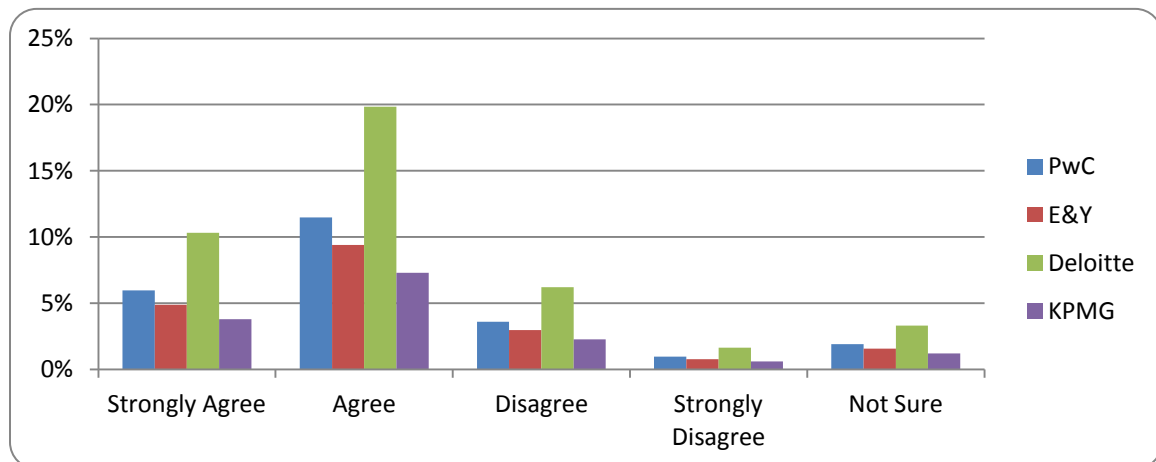


FIGURE 4.6: THE AUDIT PARTNER DEVOTED ADEQUATE ATTENTION AND LEADERSHIP TO THE ENGAGEMENT

The respondents were also asked whether the audit partner discussed the audit plan generally and how it addressed risks relating to accounting and audit with the AC. From the findings, it is clear that 44% of the respondents agreed that this was the case while 31% strongly agreed. Other respondents 13% and 6% of the total respondents strongly disagreed and disagreed respectively, that the audit partner discussed the audit plan generally and how it addressed risks relating to accounting and audit with the AC. In addition to the above, 6% of the respondents were not sure whether this was the case. While the majority agrees that the auditor discussed the audit plan and how it addressed key risks, nearly 20% of the auditors were assessed as having not had this discussion. This implies a higher risk for the minority performing a low quality audit. In addition, a minority of the ACs were found not to have ensured that the external audit plan was adequate in addressing key risks.

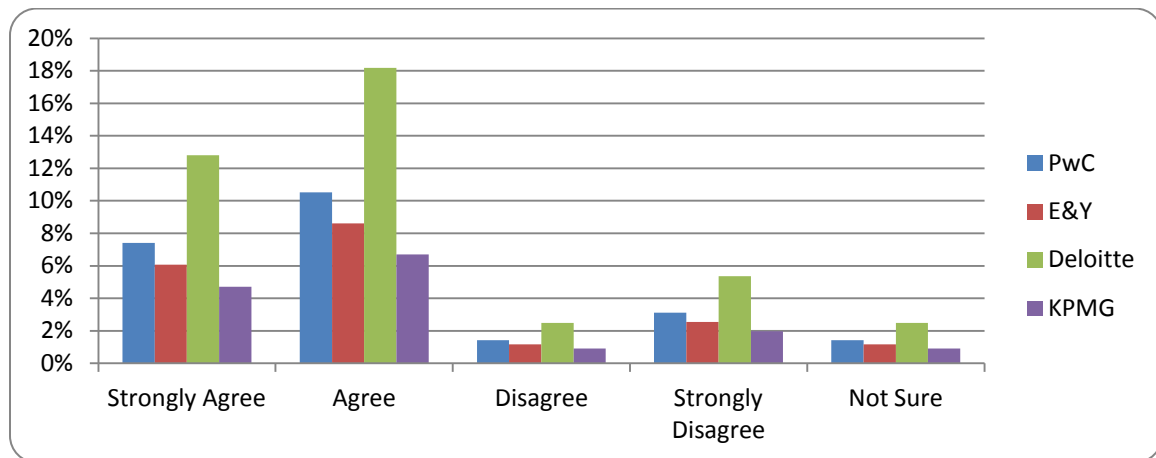


FIGURE 4.7: THE AUDIT PARTNER DISCUSSED THE AUDIT PLAN AND HOW IT ADDRESSED RISKS RELATING TO ACCOUNTING AND AUDIT WITH THE AC

The research sought to establish whether the audit partner identified the relevant risks in their audit plans. The findings indicate that 42% of the respondents agree that the audit partner identified the relevant risks in planning the audit. This is followed by 25% of the respondents who strongly agreed. The study findings also indicate that 19% and 6% of the respondents disagree and strongly disagree respectively that audit partner identified the relevant risks during audit planning while 8% were not sure whether this was the case. This implies that up to 25% of the auditors did identify those risks that needed to be

addressed in order to perform a high quality audit. Additionally, up to 8% of the ACs were not clear on whether key risks were identified for the purpose of performing a high quality audit. The implication is that this section of the ACs was not keen on this requirement and this bears adversely on the quality of their review work.

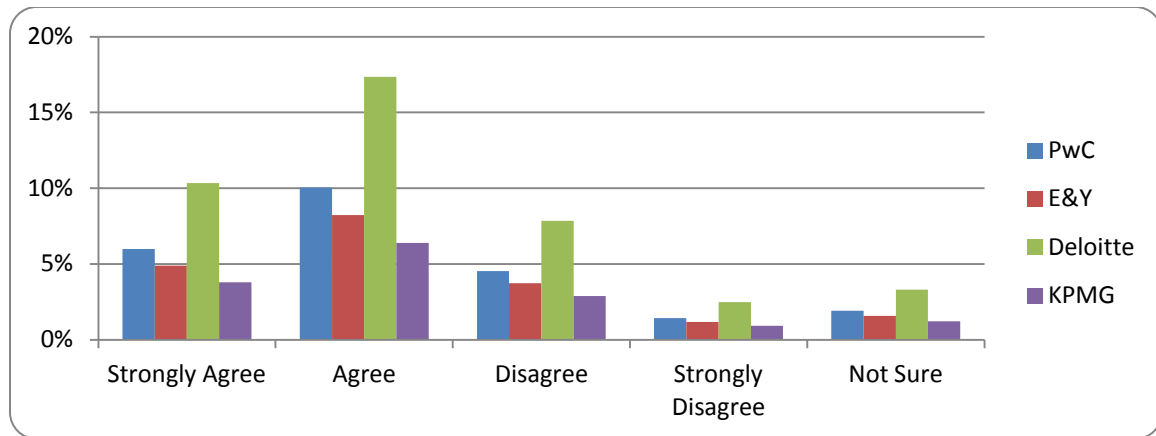


FIGURE 4.8: THE AUDIT PARTNER IDENTIFIED RELEVANT RISKS IN PLANNING THE AUDIT

The research sought to find out whether the audit partner discussed any financial statements fraud risks that were factored into the audit plan. The findings indicate that 52% of the respondents agree while 27% strongly agree that the audit partner discussed financial statement fraud risks that were considered into the audit plan. This is as opposed to 8% who disagreed, 7% who strongly disagreed and 6% who were not sure whether the audit partner discussed any financial statement fraud risks that were factored into the audit plan. This indicates that the majority (up to 79%) of the auditors pay attention to financial fraud controls which high quality audits would address.

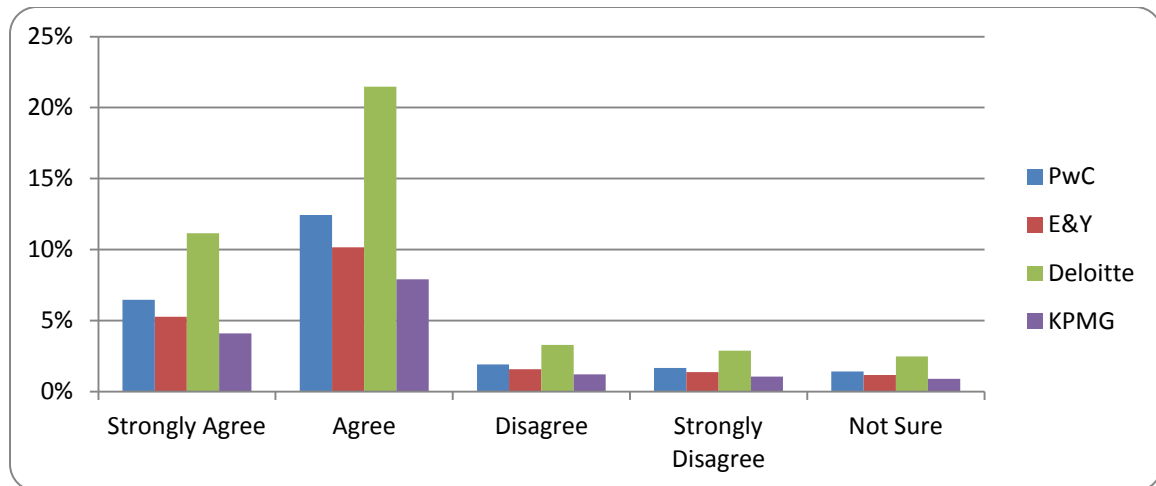


FIGURE 4.9: THE AUDIT PARTNER DISCUSSED FINANCIAL STATEMENT FRAUD RISKS CONSIDERED IN THE AUDIT PLAN

The study sought to find out whether the auditor met the agreed performance criteria documented in the engagement letter and audit scope. The researcher found out that majority of the respondents 44% agreed while 17% strongly agreed that their auditor met the agreed performance criteria. This was as opposed to 25% and 10% of the respondents who disagreed and strongly disagreed respectively. In addition, 4% of the respondents were not sure whether their auditor met the agreed upon performance criteria. Deviations from the agreed performance criteria increase the probability that the pre planned audit quality may not be achieved. It was noted that up to 35% of auditors did not fully perform the audits as per the engagement letter and audit scope and this was spread across all Big 4 audit firms. However, the majority (up to 61%) of auditors were assessed to have performed audits as per the engagement letter and audit scope meaning that the pre-set audit quality levels were likely to have been achieved.

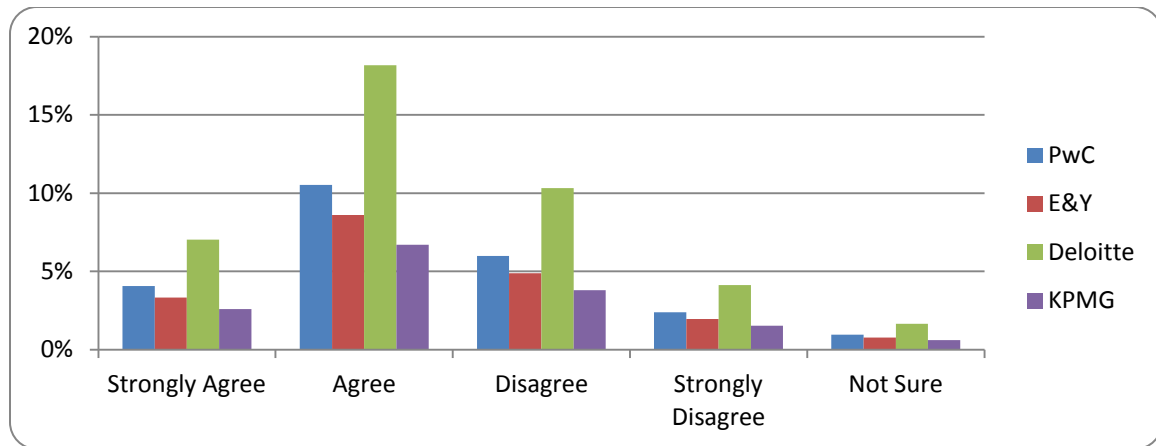


FIGURE 4.10: THE AUDITOR MET THE AGREED PERFORMANCE CRITERIA IN THE ENGAGEMENT LETTER

The research also sought responses on whether the auditor revised the audit plan in light of changing risks and circumstances. The findings were that 48% and 21% of the respondents agreed and strongly agreed respectively that the auditor revised the audit plan in view of changing risks and circumstances. On the other hand 21% and 6% disagreed and strongly disagreed respectively that their auditor revised the audit plan in line with changing risks and circumstances. This is as opposed to 4% of the respondents who were not sure. This criteria aims to ensure that the audit plan remains current in addressing relevant risks. This has a direct bearing on the audit quality. ACs assessed that up to 27% of the auditors spread among all the Big 4 firms did not change or revise their audit plans to address emerging key risks.

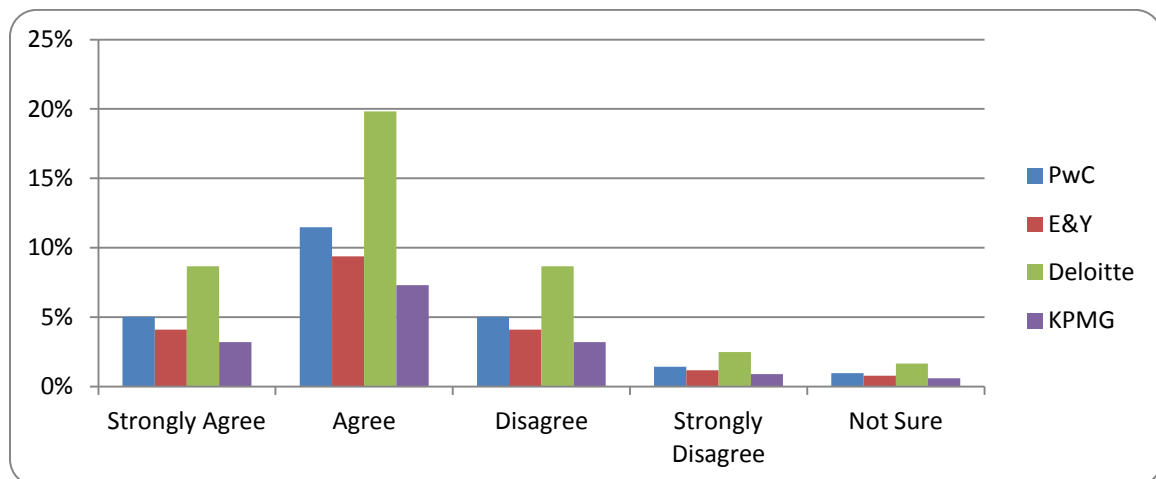


FIGURE 4.11: THE AUDITOR REVISED THE AUDIT PLAN IN LIGHT OF CHANGING RISKS AND CIRCUMSTANCES

The research sought responses on whether the AC understood the changes made by external auditors and whether they agreed that they were necessary. From the study, 48% of the respondents agree that AC understood the changes and agreed that they were necessary while 23% of the respondents strongly agreed. The study found out that 21% of the respondents disagreed, 4% strongly disagreed while 4% stated that it was not applicable that the AC understood the changes and agreed that they were necessary. While the majority (up to 71%) of the auditors were assessed as making changes understood by the ACs, it was noted that up to 25% of the ACs did not understand the changes to the audit plan made by the auditors. This implies that the percentage of ACs who were not clear on the changes made may also not have been in a position to evaluate the audit quality of their auditors.

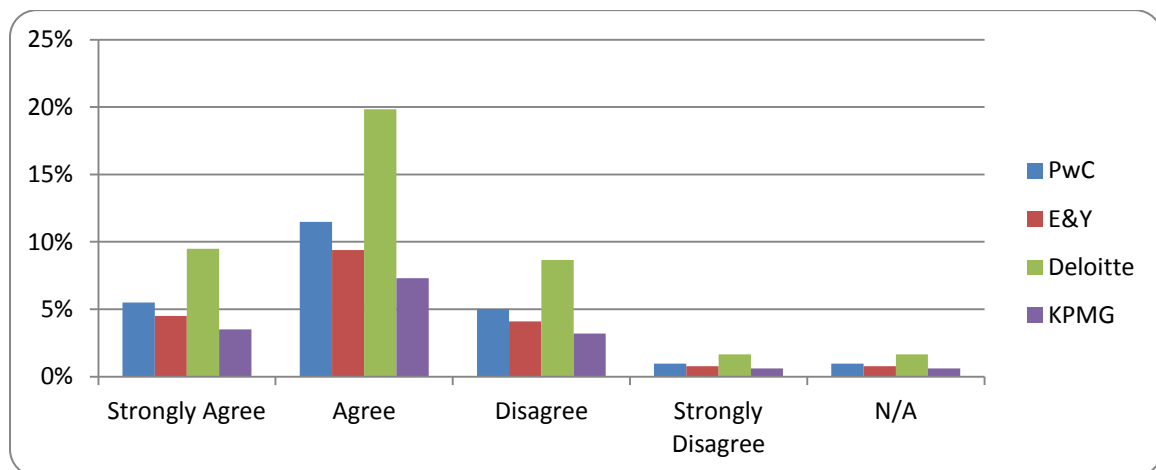


FIGURE 4.12: AC UNDERSTOOD THE CHANGES MADE BY THE AUDITORS AND AGREED THAT THEY WERE NECESSARY

The research also planned to find out whether the partner in charge advised the AC of the outcomes of deliberations with the firm's network practice or other experts on technical issues. The findings indicate that 60% of the respondents agree whereas 17% strongly agree with this requirement. On the other hand, 13% of the respondents disagreed while 4% strongly disagreed that the partner in charge advised the AC of the outcomes of deliberations with the firm's network practice or other experts on technical issues. 6% of the respondents thought this was not applicable to their organizations. This implies that up to 77% of the auditors among all Big 4 firms maintained close communication with the AC to ensure that the clients audit needs were met especially in technical issues.

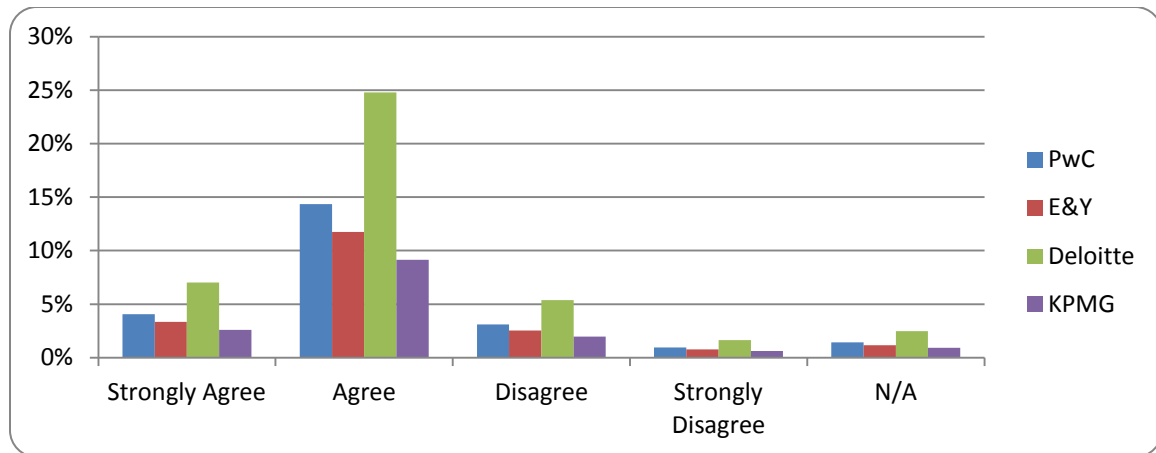


FIGURE 4.13: THE PARTNER IN CHARGE ADVISED THE AC OF THE OUTCOMES OF DELIBERATIONS WITH THE FIRM'S NETWORK PRACTICE OR OTHER EXPERTS ON TECHNICAL ISSUES

The respondents were asked whether the audit fee was realistic and justifiable for the size, complexity and risks of the company. From the findings, 52% of the respondents agree while 19% strongly agreed that the audit fee charged was realistic and justifiable for the size, complexity and risks of the company. In addition to these findings, the researcher also found out that 15% and 8% of the respondents disagreed and strongly disagreed respectively while 6% of the respondents were not sure whether the audit fee charged was realistic and justifiable for the size, complexity and risks of the company. The research also inquired on the reasons for any changes to audit fee, for instance, because of changes in scope of work and whether the changes were communicated to the AC. The findings indicate that 50% and 15% of the respondents agreed and strongly agreed that this was the case while 17% and 15% disagreed and strongly disagreed. 3% of the respondents stated that this was not applicable. This implies that the ACs viewed the fees charged as value for money. Audit fee as an indicator of audit quality suggests that the auditors across all Big 4 firms performed audits to the quality expected of them by the AC.

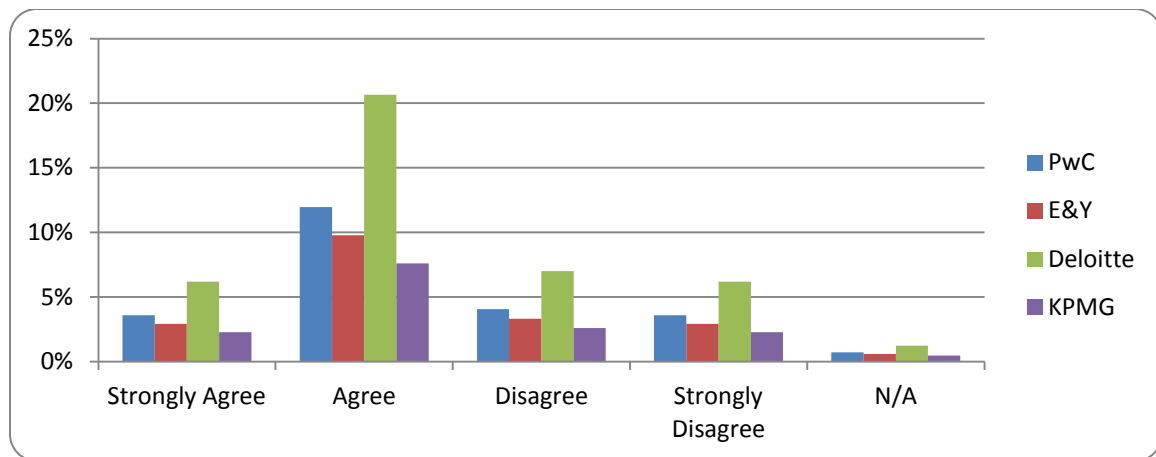


FIGURE 4.14: REASONS FOR ANY CHANGES TO AUDIT FEES WERE COMMUNICATED TO THE AC

The research also aimed to find out whether audit committee agreed with the reasons given by the auditors. The findings indicate that 63% of the respondents agreed that the audit committee agreed with the reasons given while 17% of the respondents strongly agreed. Apart from the above 8% and 6% disagreed and strongly disagreed respectively that their audit committee agreed with the reasons given by the auditors for change to costs. 6% of the respondents stated that this was not applicable in their organizations. This implies that the justification for change in audit fees across Big 4 firms was satisfactory from an audit quality point of view. The auditors revised their audit fee consistent with the scope of work that would ensure high audit quality based on the client's needs.

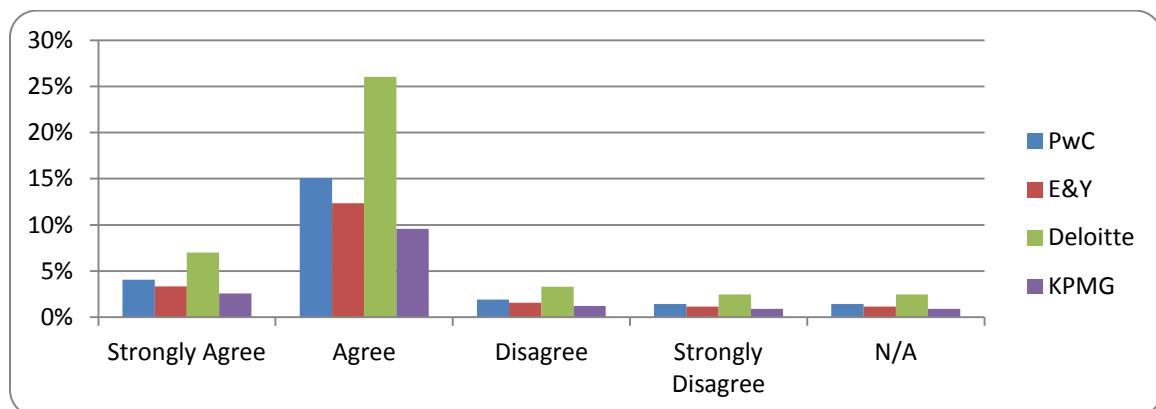


FIGURE 4.15: AC AGREED WITH THE REASONS GIVEN BY THE AUDITORS

The research also sought to find out whether the audit firm had the required industry exposure, expert knowledge in the relevant accounting policies, and location coverage needed to meet the company's needs. From the findings, it is clear that 67% of the respondents agreed while 15% strongly agreed that their the audit firm had the required industry exposure, expert knowledge in the relevant accounting policies, and location coverage needed to meet the company's needs. The research also found out that 8% of the respondents disagreed, 6% strongly disagreed and 4% stated that they were not sure that the audit firm had the required industry exposure, expert knowledge in the relevant accounting policies, and location coverage needed to meet the company's needs. The implication is that up to 82% of the Big 4 firms had the knowledge, experience and capacity to perform a high quality audit. However, up to 4% of the respondents had not paid close attention to this audit quality attribute implying a deficiency in their audit quality assessment.

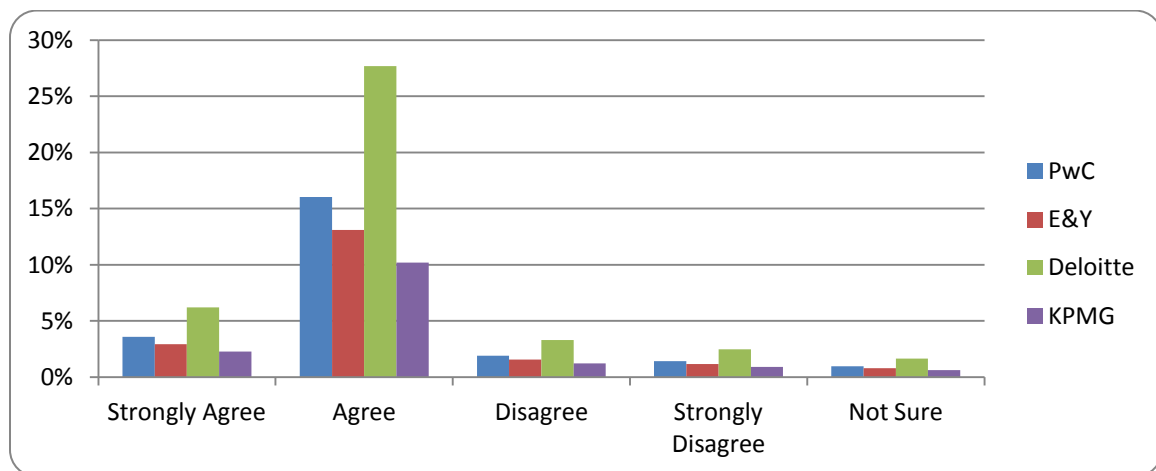


FIGURE 4.16: THE AUDIT FIRM HAD THE REQUIRED INDUSTRY EXPOSURE, EXPERT KNOWLEDGE IN THE RELEVANT ACCOUNTING POLICIES, AND LOCATION COVERAGE NEEDED TO MEET THE COMPANY'S NEEDS

The study also sought to find out from the respondents whether the auditors had adequate access to specialized skills to perform the audit. The findings indicate that majority of the respondents 52% agreed and 31% strongly agreed that the auditors had adequate access to specialized skills to perform the audit. From the findings, 11% of the respondents disagreed, 4% strongly disagreed while 2% were not sure whether the audit engagement team had adequate access to specialized skills to perform the audit. This implies that the

auditors across the Big 4 firms largely (up to 82%) possess the skills set necessary to perform a high quality audit.

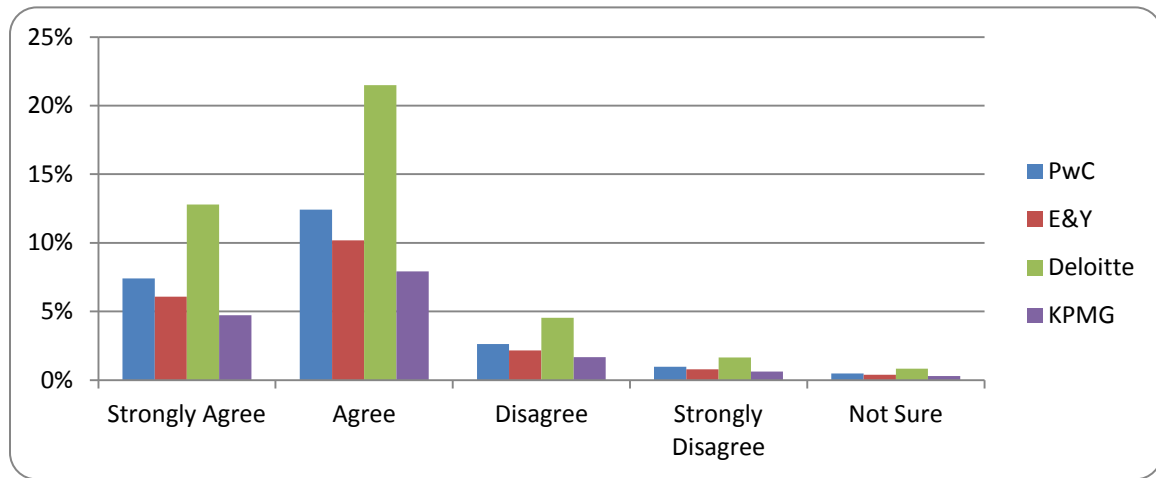


FIGURE 4. 17: THE AUDITORS HAD ADEQUATE ACCESS TO SPECIALIZED SKILLS TO PERFORM THE AUDIT

4.4 Communication and Interaction with the Auditor

The research was also interested in assessing the quality of communication and interaction between the external auditor and the client's AC. The research sought to find out whether the audit partner maintained open and detailed dialogue with the AC and AC chair. The findings indicate that 42% agreed while 15% strongly agreed that this was the case. On the hand, 25% disagreed, 10% strongly disagreed while 8% of the respondents were not sure whether the audit partner maintained open and detailed dialogue with the AC and AC chair. The research also sought responses on whether the discussions held were frank and complete. The findings indicate that majority thought this was not the case since 29% of the respondents disagreed. This was followed by those who agreed with 27% while those who strongly agreed were 25%. Part of the findings indicates that 11% strongly disagreed whereas 8% were not sure whether the discussions were frank and complete. The implication is that opportunities for audit quality improvements could be lost if discussions are not open and frank. For instances, where ACs are more knowledgeable about certain aspects of the business, the auditors would be unable to tap into this knowledge base to better improve the quality of their work.

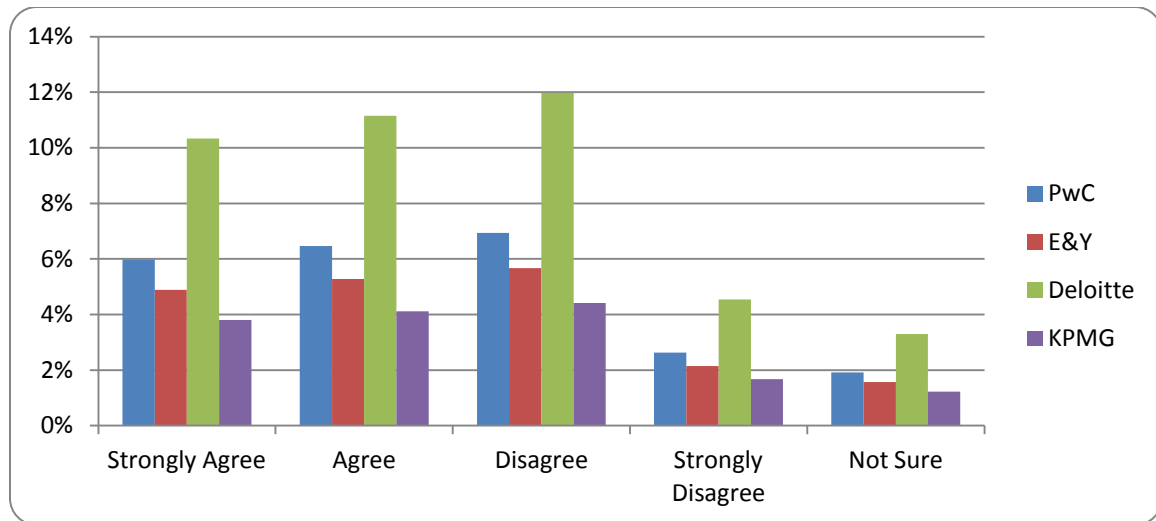


FIGURE 4.18: DISCUSSIONS BETWEEN THE AUDITOR AND AC WERE FRANK AND COMPLETE

The study also wanted to establish whether the audit partner explained technical issues in a comprehensible manner. The findings indicate that majority of the respondents 31% agree, 25% strongly disagreed while 23% disagreed that the audit partner explained technical issues in a comprehensible manner. 17% strongly agreed but 4% of the respondents were not sure as to whether the audit partner explained technical issues in a comprehensible manner. As a result of the lack of openness and frankness of discussions, ACs could also not understand clearly the explanations on technical issues. This implies that inaccurate explanations on technical issues could not be challenged by the ACs to improve the quality of work of the auditors.

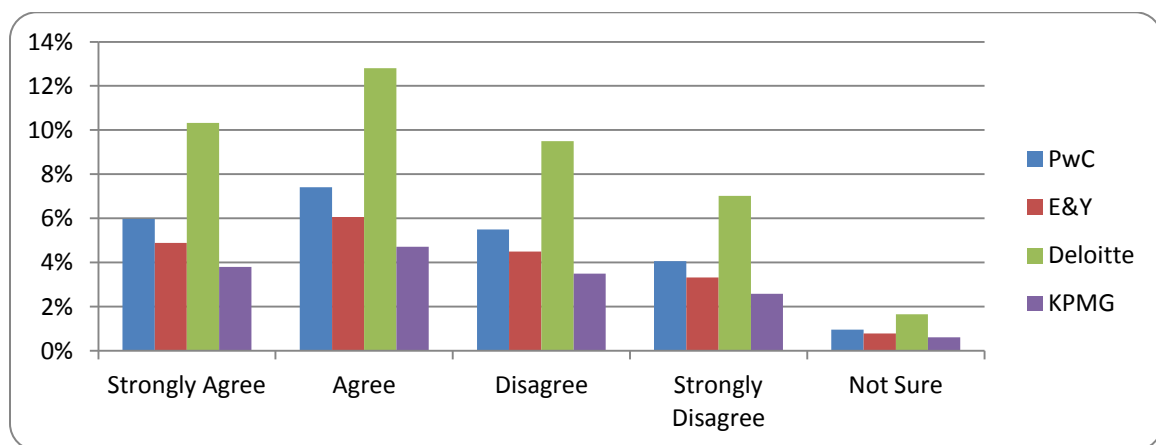


FIGURE 4.19: THE AUDIT PARTNER EXPLAINED TECHNICAL ISSUES IN AN COMPREHENSIBLE MANNER

The research sought to find out whether the audit team reviewed the appropriateness of financial reporting process and the quality of accounting estimates and judgments. From the findings it indicates 33% of the respondents agree whereas 29% of the respondents disagreed while 22% strongly agreed that the audit team reviewed the appropriateness of financial reporting process and the quality of accounting estimates and judgments. Other respondents representing 8% strongly disagreed, the same case as those who were not sure as to whether the audit team reviewed the appropriateness of financial reporting process and the quality of accounting estimates and judgments. Where the quality of the financial reporting process and accounting estimates and judgments is not thoroughly reviewed, there are risks of errors and fraud that bear adversely on audit quality. Up to 30% of respondents assessed that the auditors did not review the quality of the financial reporting process and accounting estimates and judgments in a manner that would assure audit quality.

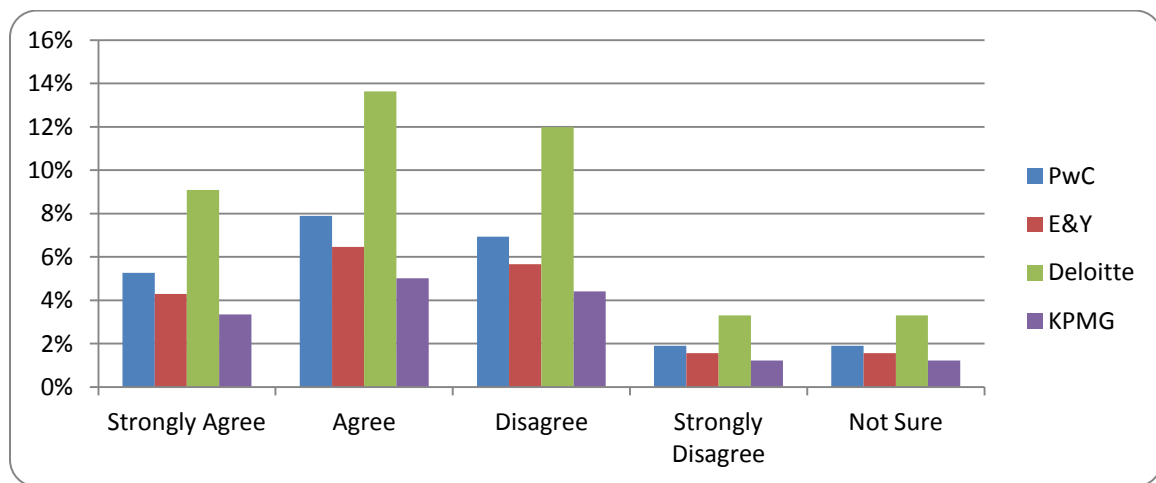


FIGURE 4.20: THE AUDIT TEAM REVIEWED THE APPROPRIATENESS OF FINANCIAL REPORTING PROCESS AND THE QUALITY OF ACCOUNTING ESTIMATES AND JUDGMENTS

The research planned to find out whether the audit team reviewed accounting policies used and compared them to industry trends and benchmarks. The findings indicate that 44% of the respondents agreed that the audit team reviewed accounting policies used and compared them to industry trends and benchmarks while on the other hand 33% disagreed. At the same time 13% of the respondents strongly agree, 8% strongly

disagreed while 2% were not sure whether the audit team reviewed accounting policies used and compared them to industry trends and benchmarks. In addition to identifying accounting policies in use by the client, these policies were not compared to best practices for appropriateness by up to 40% of the auditors. Such comparison would serve to justify the appropriateness of the policies and assure audit quality.

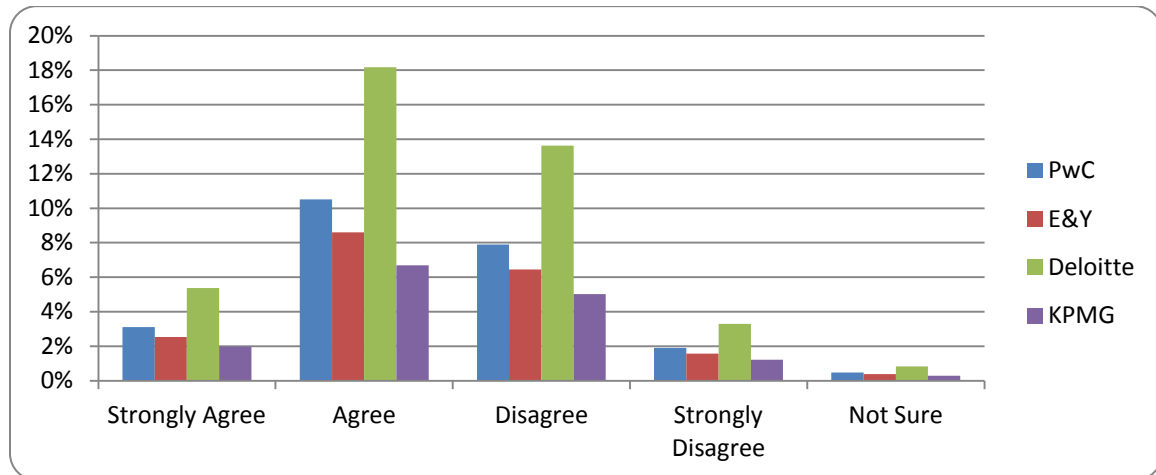


FIGURE 4.21: THE AUDIT TEAM REVIEWED ACCOUNTING POLICIES USED AND COMPARED THEM TO INDUSTRY TRENDS AND BENCHMARKS

The respondents were also asked whether in top level meetings, the auditor discussed critical matters frankly and professionally. These issues relate to views including any concerns on the company's reporting processes, financial reporting controls such as whistle blowing policy and the quality of the finance leadership team. The study findings indicate that 52% of the respondents agreed that this was the case while 21% disagreed that this was not the case. On the other hand, 15% strongly agreed with this, 6% strongly disagreed while another 6% of the respondents stated that was not applicable. This indicates that the majority (up to 67% across all Big 4 firms) of the auditors provided quality audits by discussing with top management teams, audit issues of concern. Top management team is ultimately responsible for the system of internal controls. Frank and professional discussions with them ensure that quality audits are performed through implementation of effective corrective actions.

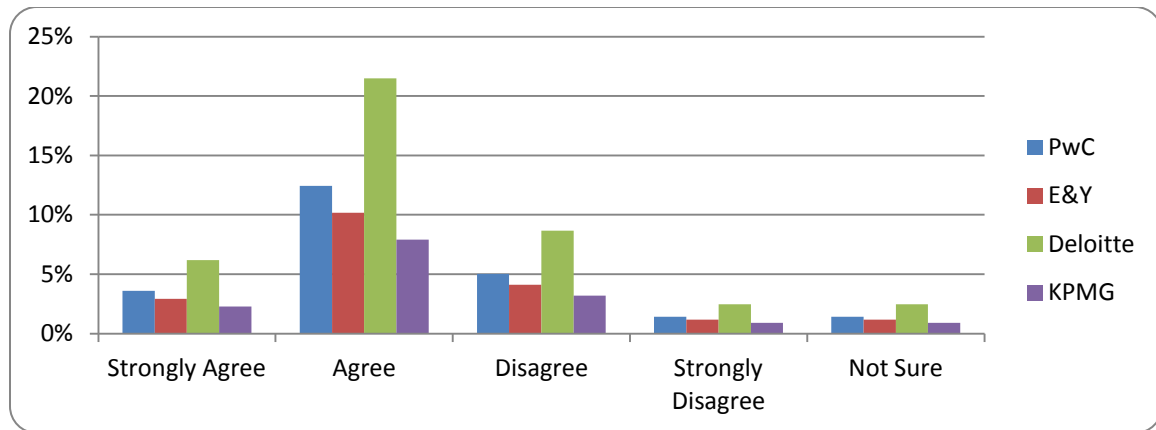


FIGURE 4.22: IN TOP LEVEL MEETINGS, THE AUDITOR DISCUSSED CRITICAL MATTERS FRANKLY AND PROFESSIONALLY

The research inquired on whether the audit partner quickly notified the AC when they were not receiving sufficient cooperation when performing the audit. From the findings, it was noted that 40% of the respondents agreed that the audit partner quickly notified the AC when they were not receiving sufficient cooperation when performing the audit while 19% disagreed. 17% of the respondents strongly agreed, 15% strongly disagreed while the rest - 24% stated that this was not applicable to them. This indicates that up to 34% of the auditors across all Big 4 firms do not seek the AC's intervention to ensure they either complete their audits in a timely manner or to ensure they get access to all the information necessary to conduct a quality audit.

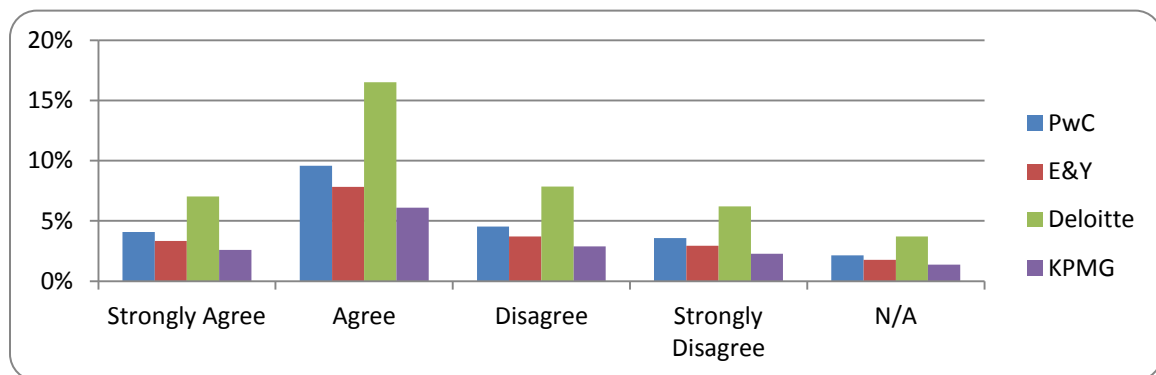


FIGURE 4.23: THE AUDIT PARTNER QUICKLY NOTIFIED THE AC WHEN THEY WERE NOT RECEIVING SUFFICIENT COOPERATION

The respondents were also asked whether the auditor ensured that the AC was briefed on current trends in auditing and accounting and the potential impact on the audit. The findings indicate that 54% of the respondents agreed while 19% disagreed. In addition to the above, 13% of the respondents strongly agreed, 6% stated that they strongly disagreed while 8% said it was not applicable to them. The majority (up to 67% across all Big 4 firms) of the auditors were assessed as keeping abreast with the current trends in auditing and accounting to enable them discharge their work effectively.

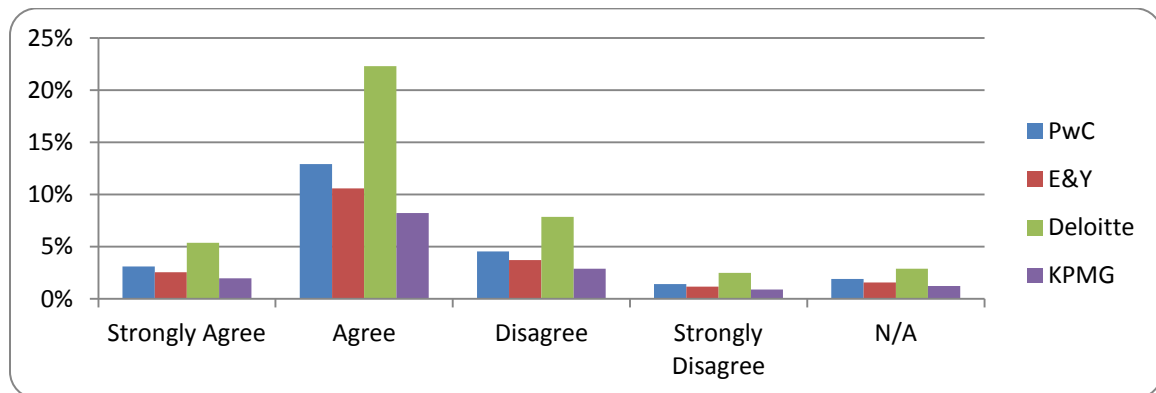


FIGURE 4.24: THE AC WAS BRIEFED ON CURRENT TRENDS IN AUDITING AND ACCOUNTING AND THE POTENTIAL IMPACT ON THE AUDIT

4.5 Auditor Independence, Objectivity and Professional Scepticism

The research also sought to assess quality checks relating to auditor independence, objectivity and professional scepticism. The research inquired on whether the audit firm reported to the AC all instances that may put to risk the firm's independence. The findings indicated that 36% of the respondents agreed while 27% disagreed with this. 17% strongly agreed. 13% strongly disagreed while 7% were not sure as to whether the audit firm reported to the AC all instances that may put to risk the firm's independence. This indicates that up to 40 % of the auditors across all Big 4 firms did not report all independent risks. Independence risk implies that audit quality may be adversely affected as the auditors try to protect their own interests.

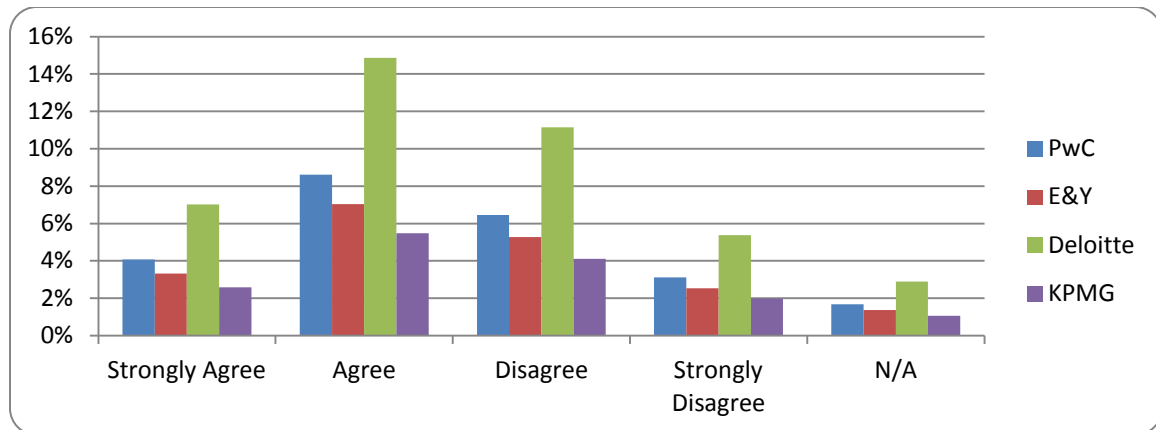


FIGURE 4.25: THE AUDIT FIRM REPORTED TO THE AC ALL INSTANCES THAT MAY PUT TO RISK THE FIRM'S INDEPENDENCE

The respondents were also asked whether the audit firm had mechanisms in place to identify independence concerns. The findings indicate that 53% of the respondents agreed that the audit firm had mechanisms in place to identify independence concerns while 17% disagreed. 13% of the respondents strongly agreed, 9% strongly disagreed while 8% were not sure whether the audit firm had mechanisms in place to identify independence concerns. While up to 66% of the auditors were assessed as having independence checks that would ensure audit quality, up to 8% of the ACs were not attentive to this audit quality attribute.

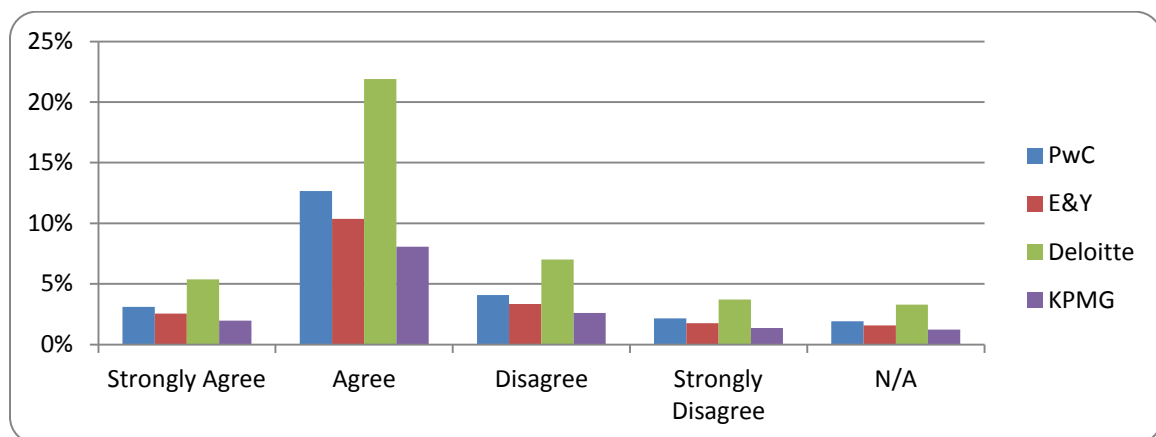


FIGURE 4.26: THE AUDIT FIRM HAD MECHANISMS IN PLACE TO IDENTIFY INDEPENDENCE ISSUES

Separately, the research sought to establish the whether the auditor had a clear perspective on technical matters where management's point of view was different. 39% of the respondents agreed that the auditor had a clear perspective on technical matters where

management's point of view was different as opposed to 21% who disagreed. 19% of the respondents strongly agreed, 15% strongly disagreed while 6% stated that this was not applicable in their organizations. This indicates that up to 36% of the auditors across all the Big 4 firms were unable to convince the client's management where their views on technical matters differed from those of client's management. This bears adversely on audit quality since the auditor's recommendations in such instances would not be adopted.

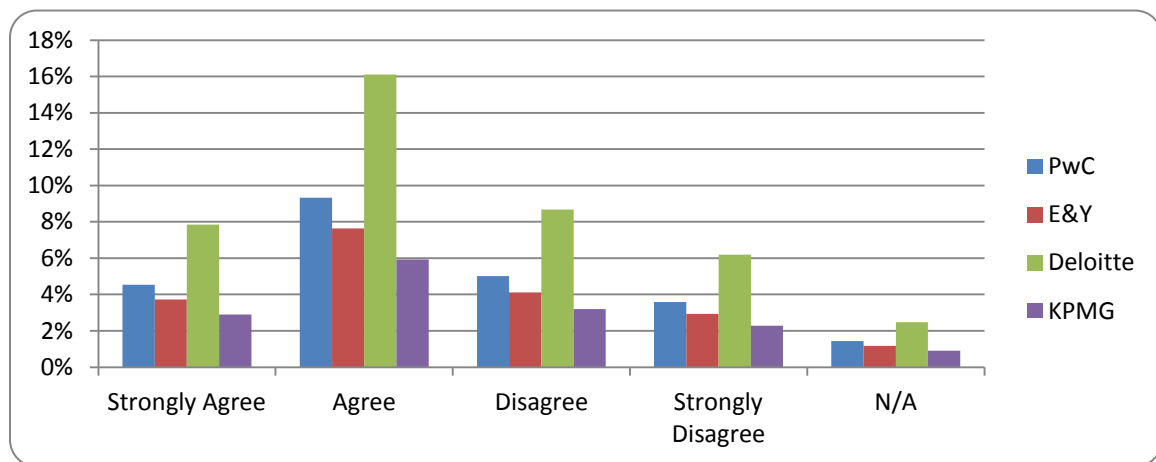


FIGURE 4.27: THE AUDITOR HAD A CLEAR PERSPECTIVE ON TECHNICAL MATTERS WHERE MANAGEMENT'S POINT OF VIEW WAS DIFFERENT

The research inquired on whether where the auditor relied on internal audit's work and management assertions, the AC agreed with the level of such reliance. The findings indicate that 50% of the respondents agreed while 25% strongly agreed that where the auditor relied on internal audit's work and management assertions, the AC agreed with the level of such reliance. The research found out that 13% disagreed, 8% strongly disagreed while 4% stated that where the auditor relied on internal audit's work and management assertions, the AC agreed with the level of such reliance. This indicates that the majority (up to 75%) of the auditors sought to better understand the client's operating environment and risks in the performance of their work by relying on business insiders. This means that audits performed would be of high quality since the auditors were well versed with the client's operating environment.

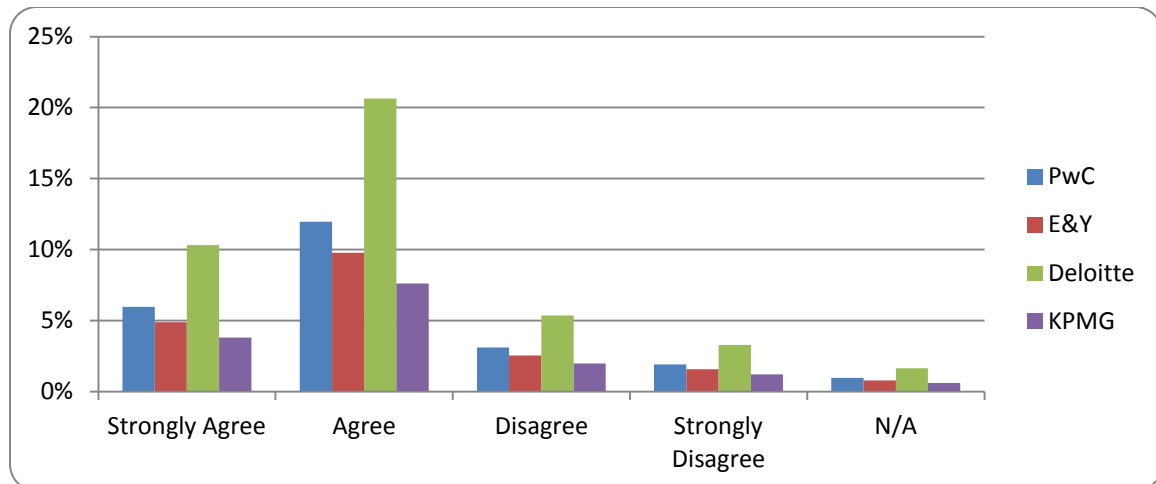


FIGURE 4.28: WHERE THE AUDITOR RELIED ON INTERNAL AUDIT'S WORK AND MANAGEMENT ASSERTIONS, THE AC AGREED WITH THE LEVEL OF SUCH RELIANCE

The study also sought to find out whether the audit partner obtained pre-approval to provide all non-audit services. The findings indicate that majority 42% agreed, 17% strongly agreed while 25% disagreed that the audit partner obtained pre-approval to provide all non-audit services. Also the study found out that 10% strongly disagreed while 6% stated that this was not applicable. This implies that up to 35% of the auditors across all Big 4 firms provided non-audit services that would have put their independence at risk without seeking AC pre approval. This bears adversely on audit quality.

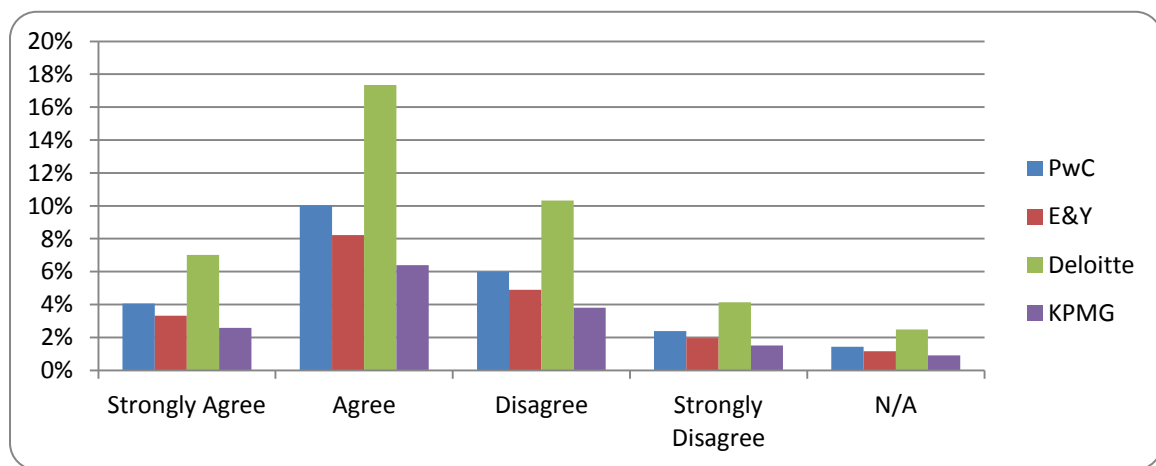


FIGURE 4.29: THE AUDIT PARTNER OBTAINED PRE-APPROVAL TO PROVIDE ALL NON-AUDIT SERVICES

Lastly, the research sought to find out whether in obtaining pre-approval from the AC for all non-audit services, the audit partner explained mechanisms in place to guard the

independence, objectivity and professional scepticism of the audit team where non-audit services were provided. The findings indicate that 50% of the respondents agreed, 31% strongly agreed while 13% disagreed. This is as opposed to 2% of the respondents who strongly disagreed while 4% stated that this was not applicable to them. This indicates that a majority (up to 81% of the auditors across all Big 4 firms) had checks in place to ensure that audit quality was not adversely affected by the provision of non-audit services.

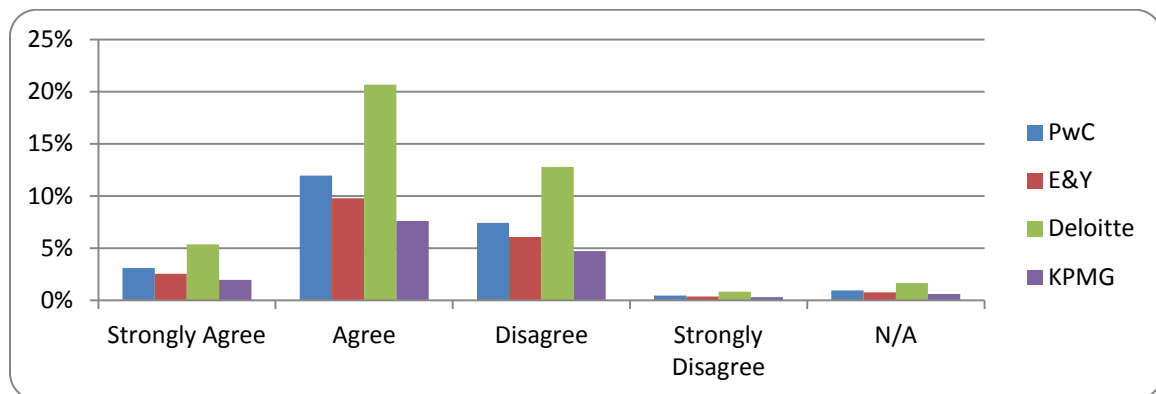


FIGURE 4.30: THE AUDIT PARTNER EXPLAINED MECHANISMS IN PLACE TO GUARD THE OBJECTIVITY, INDEPENDENCE AND PROFESSIONAL SCEPTICISM OF AUDITORS WHERE NON-AUDIT SERVICES WERE PROVIDED

4.6 Analysis of Variance (ANOVA) Results

This was done using the Statistical Package for Social Scientist (SPSS) software, one-way analysis of variance (abbreviated one-way ANOVA) which is a technique used to test the equality of three or more means at one time by using variances. To perform a one-way ANOVA, the number of samples, the sample means, the sample variances, and the sample sizes are required.

4.6.1 Interpretation of output from One-way ANOVA

Descriptive

The table gives the following information about each group: Means, Standard Deviation, Minimum and Maximum values. The results are presented as per the 3 segments provided in the CAQ tool for every Big 4 audit firm.

Table 4.2: ANOVA Results Table Descriptive

		N	Mean	Std. Deviation	Std. Error
Quality of services and sufficiency of resources provided by the auditor	PwC	11	50.72	.000	.000
	Ernst & Young	9	50.77	.000	.000
	KPMG	7	50.71	.000	.000
	Deloitte	19	50.73	.000	.000
Communication and interaction with the auditor	PwC	11	20.27	.000	.000
	Ernst & Young	9	20.22	.000	.000
	KPMG	7	20.29	.000	.000
	Deloitte	19	20.26	.000	.000
Auditor independence, objectivity and professional scepticism	PwC	11	20.20	.000	.000
	Ernst & Young	9	20.88	.000	.000
	KPMG	7	20.86	.000	.000
	Deloitte	19	20.84	.000	.000

		95% Confidence Interval for Mean		Minimum	Maximum
		Lower Bound	Upper Bound		
Quality of services and sufficiency of resources provided by the auditor	PwC	1.00	1.00	1	1
	Ernst & Young	1.00	1.00	1	1
	KPMG	1.00	1.00	1	1
	Deloitte	1.00	1.00	1	1
Communication and interaction with the auditor	PwC	.95	1.65	1	2
	Ernst & Young	2.00	2.00	2	2
	KPMG	1.95	2.65	2	3
	Deloitte	2.87	3.33	3	4
Auditor independence, objectivity and professional scepticism	PwC	.90	1.50	1	2
	Ernst & Young	2.00	2.00	2	2
	KPMG	2.03	2.77	2	3
	Deloitte	2.87	3.33	3	4

4.6.2 Decision rule

The table below gives both between groups and within groups sum squares, degrees of freedom, mean squares and the F value. Of interest, is the column marked **Sig**. If the Sig

value is less than or equal to 0.05, then there is insignificant difference among the mean scores. In this analysis, the overall significant value is .01 which is less than .05, indicating a statistically insignificant result. In other words, Big 4 audit firms largely provide homogenous audit quality since there is no significant difference in their mean scores.

Table 4.3: ANOVA Results Table (Decision Rule)

		Sum of Squares	df	Mean Square	F
Quality of services and sufficiency of resources provided by the auditor	Between Groups	12.604	3	3.151	72.264
	Within Groups	1.875	43	.044	
	Total	14.479	46		
Communication and interaction with the auditor	Between Groups	52.713	3	13.178	79.811
	Within Groups	7.100	43	.165	
	Total	59.813	46		
Auditor independence, objectivity and professional scepticism	Between Groups	51.142	3	12.785	81.147
	Within Groups	6.775	43	.158	
	Total	57.917	46		

		Sig.
Quality of services and sufficiency of resources provided by the auditor	Between Groups	.01
	Within Groups	
	Total	
Communication and interaction with the auditor	Between Groups	.01
	Within Groups	
	Total	
Auditor independence, objectivity and professional scepticism	Between Groups	.01
	Within Groups	
	Total	

4.7 Audit Committee Extent of Use of the CAQ Tool

The table below summarizes the questions that the respondents answered 'Not Sure' to. This indicates that the respondents were not aware of or were not performing such reviews on the work of external auditors. This bears adversely on the quality of their review work on the practice of external auditors. It was noted that the proportion of the 'Not Sure' responses were minimal as summarized below.

Table 4.4: AC Extent of Use of the CAQ Tool

Question	% of respondents representing 'Not Sure'
The auditors requested feedback on the quality of the audit performed	6
The auditors responded constructively to feedback given on the quality of audit performed	6
The audit partner had access to the AC and management	6
The audit partner devoted adequate attention and leadership to the engagement	8
The audit partner discussed the audit plan and how it addressed risks relating to accounting and audit with the AC	6
The audit partner identified relevant risks in planning the audit	8
The audit partner discussed financial statement fraud risks considered in the audit plan	6
The auditor met the agreed performance criteria in the engagement letter	4
The auditor revised the audit plan in light of changing risks and circumstances	4
The audit firm had the required industry exposure, expert knowledge in the relevant accounting policies, and location coverage needed to meet the company's needs	4
The auditors had adequate access to specialized skills to perform the audit	2
Discussions between the auditor and AC were frank and complete	8
The audit partner explained technical issues in an comprehensible manner	4
The audit team reviewed the appropriateness of financial reporting process and the quality of accounting estimates and judgments	8
The audit team reviewed accounting policies used and compared them to industry trends and benchmarks	2
In top level meetings, the auditor discussed critical matters frankly and professionally	6

Since these percentages represent a minority (up to 8%), it can be concluded that ACs largely apply the CAQ tool audit quality checks in evaluating the work of external auditors. This observation also adds credibility to the findings regarding the quality of audits performed. This is because ACs largely performed the required reviews and were able to respond to questions on those reviews.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter will begin by discussing the summary of the study. The discussion will cover the purpose of the study and the methodology used to collect and analyze data from which conclusions will be made. This is followed by a section on research findings, conclusions and implications. The chapter will then proceed to discuss the limitations of the study and lastly, a section covering recommendations for further research.

5.2 Summary of the Study

The purpose of the study was to examine whether audit quality differences exist among Big 4 audit firms based on the concern that the Big 4 firms have tended to be perceived to be providing homogenous audit quality (Deangelo (1981); Davidson and Neu (1993); Colbert and Murray (1998); Lennox and Pittman (2011). The perception of homogeneity existed before the collapse of Arthur Andersen. The collapse of Arthur Andersen, a Big 5 audit firm up to 2002, inspired this research to demystify whether a lower quality audit firm among the group exists but hiding behind the veil of the Big 4 label of quality. To evaluate whether audit quality differences exist among the Big 4 audit firms, ANOVA was used to compare the means of the responses for each Big 4 firm. The responses were sought using questionnaires sent to AC members of firms quoted on the NSE.

The study's second objective intended to examine the extent to which ACs review the work of the external auditor using the new CAQ tool designed for ACs to annually evaluate the quality of work of external auditors. This is because ACs are mandated by the CGG to review the work of the external auditor to provide the board of directors with assurance that quality audits of financial statements are performed by the appointed external auditors. The CAQ tool is segmented in three categories of review namely quality of services and sufficiency of resources provided by the auditor, communication and interaction with the auditor, and auditor independence, objectivity and professional scepticism. Questions posed to the AC members had the responses designed in the form

of a 5-point likert scale that included a 'Not sure' response. 'Not sure' responses indicate a deficiency in the extent of use of the CAQ tool since the implication is that the respondent does not perform the check to effectively review the work of the external auditor. Percentage analysis was used to analyze the 'Not sure' responses.

5.3 Discussions, Conclusions and Implications

The study found that no significant audit quality differences exist among the Big 4 audit firms in Kenya. This finding is in line the proposition used in extant research on audit quality, that Big 4 firms provide homogenous audit quality (Deangelo (1981); Davidson and Neu (1993); Colbert and Murray (1998); Lennox and Pittman (2011)). The study also found that ACs to a large extent review the work of the external auditor as per the CAQ tool. This is because respondents who were not sure about having performed certain quality checks ranged between 2% and 8%. Majority of the respondents were found to have performed the quality checks as per the CAQ tool.

This study makes a number of conclusions. Firstly, the proposition used in extant research on audit quality that Big 4 audit firms provide homogenous audit quality, is supportable. Examples of such studies include those of Deangelo (1981); Davidson and Neu (1993); Colbert and Murray (1998); Lennox and Pittman (2011). However, this conclusion contrasts with that of Moizer (1997) who, using audit fee as a proxy for audit quality, concluded that PwC is a higher quality auditor because it charges higher audit fees than the rest of the Big 5 audit firms. This study's conclusion also differs with that of Fuerman (2006) who concluded that Deloitte's audit quality is lower compared to the rest of the Big 4 and Fuerman (2007) who, using the frequency of litigation rates against Big 4 audit firms, concluded that PwC is a higher quality auditor compared to the rest of the Big 4 firms. This conclusion adds to the body of literature on audit quality by supporting the proposition that Big 4 audit firms provide homogenous audit quality.

Secondly, companies whose financial statements are audited by any one of the Big 4 audit firms may be receiving largely similar audit quality. Investors may therefore place reliance on a set of financial statements audited by any one of the Big 4 audit firms since

the Big 4 represents a homogenous label of quality. Additionally, ACs in their decision to appoint a Big 4 external auditor need not heavily discriminate against any Big 4 firm on the basis of perceived audit quality differences.

Lastly, ACs are largely effective in their evaluation of the external auditor. It was noted that only a minority of ACs responded that they were not sure about the performance of the auditor on certain quality measures. For instance, 8% of ACs were not sure whether the auditors identified appropriate risks in their audit plans. 8% of the ACs in aggregate were also not sure whether discussions with the external auditor were frank and complete. The implication of this conclusion is that ACs are abiding by the CGGs provided by the CMA by performing adequate oversight over the work of the external auditor.

5.4 Recommendations for further research

The following recommendations are made for further research:

Audit quality among Big 4 firms may be assessed from the point of view of regulators to compare with findings of this study and to add to the body of audit quality literature.

Audit quality differences between Big 4 and non-Big 4 audit firms may be examined using the CAQ new tool for ACs. The purpose of this research should be to justify a proposition used in extant research on audit quality that Big 4 audit firms provide higher audit quality than their non-Big 4 counterparts.

Since ACs are charged with the responsibility of evaluating the quality of work of external auditors, research on the competence of ACs and challenges facing ACs in their evaluation of the work of external auditors would assist in making recommendations on how to increase the productivity and effectiveness of ACs.

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Appendix

Table 1: Allegations of accounting scandals involving Big 4 audit firms

Source: Summary table obtained from http://en.wikipedia.org/wiki/Accounting_scandals

Viewed on: 24th September 2012

Company	Year	Big 4 Firm	Country
Waste Management, Inc.	1999	Arthur Andersen	United States
MicroStrategy	2000	PricewaterhouseCoopers	United States
Unify Corporation	2000	Deloitte & Touche	United States
Computer Associates	2000	KPMG	United States
Lernout & Hauspie	2000	KPMG	Belgium
Xerox	2000	KPMG	United States
One.Tel	2001	Ernst & Young	Australia
Enron	2002	Arthur Andersen	United States
Adelphia	2002	Deloitte & Touche	United States
AOL	2002	Ernst & Young	United States
Bristol-Myers Squibb	2002	PricewaterhouseCoopers	United States
CMS Energy	2002	Arthur Andersen	United States
Duke Energy	2002	Deloitte & Touche	United States
Dynegy	2002	Arthur Andersen	United States
El Paso Corporation	2002	Deloitte & Touche	United States
Freddie Mac	2002	PricewaterhouseCoopers	United States
Global Crossing	2002	Arthur Andersen	Bermuda
Halliburton	2002	Arthur Andersen	United States
Homestore.com	2002	PricewaterhouseCoopers	United States
ImClone Systems	2002	KPMG	United States
Kmart	2002	PricewaterhouseCoopers	United States
Merck & Co.	2002	PricewaterhouseCoopers	United States
Merrill Lynch	2002	Deloitte & Touche	United States
Mirant	2002	KPMG	United States
Nicor	2002	Arthur Andersen	United States
Peregrine Systems	2002	KPMG	United States
Qwest Communications	1999-2002 Oct 2002	Arthur Andersen KPMG	United States
Reliant Energy	2002	Deloitte & Touche	United States
Sunbeam	2002	Arthur Andersen	United States
Tyco International	2002	PricewaterhouseCoopers	Bermuda
WorldCom	2002	Arthur Andersen	United States
Royal Ahold	2003	Deloitte & Touche	United States

Company (cont'd)	Year	Big 4 Firm	Country
HealthSouth Corporation	2003	Ernst & Young	United States
Nortel	2003	Deloitte & Touche	Canada
Chiquita Brands International	2004	Ernst & Young	United States
AIG	2004	PricewaterhouseCoopers	United States
Anglo Irish Bank	2008	Ernst & Young	Ireland
Satyam Computer Services	2009	PricewaterhouseCoopers	India
Lehman Brothers	2010	Ernst & Young	United States
Sino-Forest Corporation	2011	Ernst & Young	Canada-China
Olympus Corporation	2011	Ernst & Young	Japan
Barclays Bank	2012	PricewaterhouseCoopers	United Kingdom
Standard Chartered	2012	Deloitte & Touche	Iran

Table 2: External Auditors of listed companies in the Nairobi Securities Exchange

Source:

http://www.cma.or.ke/index.php?option=com_content&view=article&id=37&Itemid=160

Viewed on 11th October 2012

Sector	Listed Company	Audit Firm
Agricultural	Eaagads Ltd	Deloitte & Touche
	Kapchorua Tea Co. Ltd	Deloitte & Touche
	Kakuzi	PricewaterhouseCoopers
	Limuru Tea Co. Ltd	PricewaterhouseCoopers
	Rea Vipingo Plantations Ltd	Deloitte & Touche
	Sasini Ltd	Ernst & Young
	Williamson Tea Kenya Ltd	Deloitte & Touche
Commercial & Services	Express Ltd	KPMG
	Kenya Airways Ltd	Deloitte & Touche
	Nation Media Group	PricewaterhouseCoopers
	Standard Group Ltd	Deloitte & Touche
	TPS Eastern Africa (Serena) Ltd	PricewaterhouseCoopers
	Scangroup Ltd	Deloitte & Touche
	Uchumi Supermarket Ltd	Ernst & Young
	Longhorn Kenya Ltd	Deloitte & Touche
Telcom & Technology	AccessKenya Group Ltd	Deloitte & Touche
	Safaricom Ltd	PricewaterhouseCoopers
Automobile & Accessories	Car and General (K) Ltd	Deloitte & Touche
	CMC Holdings Ltd	Deloitte & Touche
	Sameer Africa Ltd	PricewaterhouseCoopers
	Marshalls (E.A.) Ltd	PricewaterhouseCoopers
Banking	Barclays Bank Ltd	PricewaterhouseCoopers
	CFC Stanbic Holdings Ltd	PricewaterhouseCoopers
	Diamond Trust Bank Kenya Ltd	PricewaterhouseCoopers
	Housing Finance Co Ltd	KPMG
	Kenya Commercial Bank Ltd	Ernst & Young
	National Bank of Kenya Ltd	Deloitte & Touche
	NIC Bank Ltd	Deloitte & Touche
	Standard Chartered Bank Ltd	KPMG
	Equity Bank Ltd	Ernst & Young
	The Co-operative Bank of Kenya Ltd	Ernst & Young
Insurance	Jubilee Holdings Ltd	KPMG
	Pan Africa Insurance Holdings Ltd	Ernst & Young
	Kenya Re-Insurance Corporation Ltd	Deloitte & Touche
	CFC Insurance Holdings	PricewaterhouseCoopers

Sector	Listed Company	Audit Firm
Insurance (cont'd)	British-American Investments Company	PricewaterhouseCoopers
	CIC Insurance Group Ltd	Deloitte & Touche
Investment	City Trust Ltd	Deloitte & Touche
	Olympia Capital Holdings ltd	Ernst & Young
	Centum Investment Co Ltd	Deloitte & Touche
	Trans-Century Ltd	KPMG
Manufacturing & Allied	B.O.C Kenya Ltd	KPMG
	British American Tobacco Kenya Ltd	PricewaterhouseCoopers
	Carbacid Investments Ltd	Deloitte & Touche
	East African Breweries Ltd	KPMG
	Mumias Sugar Co. Ltd	Deloitte & Touche
	Unga Group Ltd	Deloitte & Touche
	Eveready East Africa Ltd	DCDM Associates
	Kenya Orchards Ltd	Jessie and Associates
	A.Baumann Co Ltd	PKF
Construction & Allied	Athi River Mining	Deloitte & Touche
	Bamburi Cement Ltd	Deloitte & Touche
	Crown Berger Ltd	Ernst & Young
	E.A.Cables Ltd	KPMG
	E.A.Portland Cement Ltd	Controller and Auditor General
Energy & Petroleum	KenolKobil Ltd	PricewaterhouseCoopers
	Total Kenya Ltd	Deloitte & Touche
	KenGen Ltd	Ernst & Young
	Kenya Power & Lighting Co Ltd	Ernst & Young

Introductory letter and Questionnaire

Introduction Letter:

Dear Sir / Madam,

My name is David Gitare, a Master of Commerce (Mcom) degree student at Strathmore University. I am currently writing my thesis on “An Examination of the Audit Quality Difference among Big 4 Audit Firms in Kenya”, in partial fulfilment of my Mcom degree.

Audit quality is a fundamental subject for quoted companies such as yours. This is because stakeholders rely on the audit report to make investment and financing decisions. Finance management also requires comfort that the numbers they are reporting can be relied on without question. Consequently, it is important that a high quality audit be performed to adequately serve these purposes.

It is a widely held belief that Big 4 audit firms (KPMG, Ernst & Young, PwC and Deloitte and Touche) provide higher quality audits compared to their non-Big 4 counterparts. My research aims to determine whether audit quality differences exist among the Big 4 audit firms.

From the foregoing, I would like to request that you spare a few minutes of your time to candidly respond to this short and simple-design questionnaire. The results of this research may assist you in assessing the level of audit quality you obtain from your external auditor and identifying areas of improvement, though this should not be construed to be professional advice. The primary purpose of this study is academic research.

I commit that I will treat your responses with utmost confidentiality and that I will avail the results of this research to you in appreciation of your participation.

Thank you in advance.

Kind Regards,
David Gitare

QUESTIONNAIRE

Thesis Topic: “An Examination of the Audit Quality Difference among Big 4 Audit Firms in Kenya – An Audit Committee’s Perspective”

Target Respondent: Audit Committee Chair

Instruction: Circle / Tick only one answer. Fill in answers on the dotted lines where required

GENERAL

1. Which audit firm is your current external auditor?

- Ernst & Young
- PricewaterhouseCoopers
- KPMG
- Deloitte & Touche
- Other (indicate name).....

2 (a) Has your current Big 4 audit firm performed an audit of your financial statements?

- Yes
- No
- Not Applicable

(b). If Yes, how long has the audit firm been your external auditor?

- 1 Year
- 2 Years
- 3 Years
- 4 Years
- 5 Years and above

(c) If No, please indicate who your previous external auditor was.

.....

Answer the next questions based on your experience with your current Big 4 audit firm. However, if no such prior experience exists, answer the next questions based on your previous audit experience with a previous Big 4 audit firm of your organization.

N/A means Not Applicable

QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE AUDITOR

1. The auditor had the necessary knowledge and skills to meet our audit requirements

- Strongly Agree
- Agree
- Disagree
- Strongly Disagree
- Not Sure

2. The appropriate resources were assigned to the audit

- Strongly Agree
- Agree
- Disagree
- Strongly Disagree
- Not Sure

3. The auditors requested feedback on the quality of the audit performed

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

4. The auditors responded constructively to feedback given on the quality of audit performed

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

5. Audit partner had access to the AC and management

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

6. The audit partner devoted adequate attention and leadership to the engagement

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

7. The audit partner discussed the audit plan generally and how it addressed risks relating to accounting and audit with the AC

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

8. The audit partner identified relevant risks in planning the audit

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

9. The audit partner discussed financial statement fraud risks considered in the audit plan

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

10. The auditor met the agreed performance criteria in the engagement letter

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

11. The auditor revised the audit plan in light of changing risks and circumstances

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

12. AC understood the changes made by the auditors and agreed that they were necessary

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

13. The partner in charge advised the AC of the outcomes of deliberations with the firm's network practice or other experts on technical issues

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

14. Reasons for any changes to audit fees were communicated to the AC

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

15. AC agreed with the reasons given by the auditor

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

16. The audit firm had the required industry exposure, expert knowledge in the relevant accounting policies, and location coverage needed to meet the company's needs

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

17. The auditors had adequate access to specialized skills to perform the audit

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

18. Discussions between the auditor and AC were frank and complete

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

COMMUNICATION AND INTERACTION WITH THE AUDITOR

1. The audit partner explained technical issues in an comprehensible manner

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

2. The audit team reviewed the appropriateness of financial reporting process and the quality of accounting estimates and judgments

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

3. The audit team reviewed accounting policies used and compared them to industry trends and benchmarks

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

4. In top level meetings, the auditor discussed critical matters frankly and professionally

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

5. The audit partner quickly notified the AC when they were not receiving sufficient cooperation

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

6. The AC was briefed on current trends in auditing and accounting and the potential impact on the audit

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

7. The audit firm reported to the AC all instances that may put to risk the firm's independence

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

AUDITOR INDEPENDENCE, OBJECTIVITY AND PROFESSIONAL SKEPTICISM

1. The audit firm had mechanisms in place to identify independence concerns

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

2. The auditor had a clear perspective on technical matters where management's point of view was different

•Strongly Agree •Agree •Disagree •Strongly Disagree •Not Sure

3. Where the auditor relied on internal audit's work and management assertions, the AC agreed with the level of such reliance

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

4. The audit partner obtained pre-approval for the provision of all non-audit services

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A

5. The audit partner explained mechanisms in place to guard the objectivity, independence and professional scepticism of the auditors where non-audit services were provided

•Strongly Agree •Agree •Disagree •Strongly Disagree •N/A