INFLUENCE OF AUDITORS' INDEPENDENCE ON FINANCIAL SUSTAINABILITY OF PUBLIC UNIVERSITIES IN KENYA; A CASE OF MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY, KENYA

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INFLUENCE OF AUDITORS' INDEPENDENCE ON FINANCIAL SUSTAINABILITY OF PUBLIC UNIVERSITIES IN KENYA; A CASE OF MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY, KENYA

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ABSTRACT

In most public universities in Kenya, there are reported cases of financial instability in both public and private university which threatens their financial sustainability. More interestingly, despite complaints from the public and Office of the Auditor General about financial sustainability issues in public universities in Kenya, most audit reports are either politicized or cancelled as malicious and lacking authenticity; a gap that motivated this study to investigate the influence of auditors independence on financial sustainability in public universities in Kenya, a case of Masinde Muliro University of Science and Technology. The study was informed by Limperg's theory of inspired confidence. Explanatory survey design was used to explain hypothesized relationships, thus the influence of the independent variable (auditors' independence) on financial sustainability (dependent variable). The study targeted 54 respondents comprising of mainly Financial Officers, Accountants, Heads of Department and Internal Auditors at Masinde Muliro University of Science and Technology. The study assumed census sampling technique. Primary data was collected by means of self-administered structured questionnaires and for purposes of validity and reliability checks, all components of the questionnaires were checked and coded to ensure clarity of words and the accuracy of the statements, then pretested in Moi University, Eldoret. Pertaining data analysis, collected data was coded, cleaned, tabulated and analyzed using descriptive and inferential statistics with the aid of specialized Statistical Package for Social Sciences, version 24. Descriptive analysis such as frequencies, means, and standard deviation was utilized whereas analyzed data was presented in tables and graphs. Further, inferential statistics assessed the nature and the strength of the relationships. Both descriptive and inferential statistics revealed that auditors' independence significantly influenced financial sustainability in Masinde Muliro University of Science and Technology. The study recommended that public universities finance managers should foster auditors' independence without compromising or conspiring with them, so as to give authentic audit reports that dully identify financial mismanagement in public universities.

Key Words; *Auditors Independence, Financial Sustainability, Public Universities*

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INTRODUCTION

In the wake of a multiplicity of economic crises, governments- both national and local, all over the world are faced with difficult choices that have global ramifications. In such difficult economic situations, governments both global and local become increasingly cognizant of the need to balance their budgets in order to avoid financial difficulties. Yet it is often difficult for governments to assess the financial distress of their localities and, more importantly, to recognize local financial difficulties before they become severe (Kloha, Weissert & Kleine, 2005). Further, security of public finance is supposed to be guaranteed by authentic financial audits. That is financial audit has been recognized as an elementary administrative scheme comprising principally of examining documents, reviewing operations and presenting to the panel of executives, board or external auditors since history. Internal audit had been known to enhance the objectives and discussions within and without the organizational departments which in turn enhanced the value within the organization (Raja, 2002). In this regard, internal audit for instance checks on financial expenditures in accordance with modern day accounting practices due to the amalgamation of diverse forces which led to a quiet revolution of the profession. Companies presently require immense capability from internal audit, in light of inadequate capital, to display enhanced competence in identifying and mitigating financial risks.

More so, there is an apprehension in the entire world whether the internal audit function has the capability to grant hitherto, divergent benefits to an organization in achieving its objectives. This latent deviated into a provocation and resulted into actualization of the meaning of internal audit by the Institute of Internal Auditors (the IIA). That is, Messier (2011), asserted that financial audit function occupies a significant part of the organizational structure of in-house control. This facilitates effective financial auditing and reporting with assurance of highest possible level of review and appraisal of various activities in an organization. The reputation whether bad or good is solely, determined by internal audit level of financial performance, which implies that the auditing functions evaluate financial performance to improve financial services. According to Beyanga (2011), internal audit may play a greater role in achieving the expectations of an organization by using strategic methodologies for determining and refining the usefulness and proficiency of the governance procedures of organizational threats and how they can be controlled.

The operationalization of internal audit, according to IIA (2016) includes the standards of internal audit, auditor independence, internal controls and competence in performing their professional duties. The adherence to internal audit standards are crucial in boosting the effectiveness of the process according to the publication of IIA (2008) including aspects such as attribute, implementation standards and performance. Further it is argued that the auditor is supposed to be independent of both the personnel related and operational related activities within the firms. This is with the aim, of not compromising the opinions of the auditor in terms of integrity, recommendations and conclusions. Also according to KPMG (2015) on detection of financial fraud, competence in performing professional financial duties is a key consideration. Further the designed audit systems within the firm should adhere to the internal checks in line with the internal audit control function which includes organizing, directing, planning and controlling program operations and the systems put in place to report, measure and monitor performance of the financial audit control program.

Globally, American Accounting Association (2003) reported that auditors are used as a mechanism to enhance credibility of the financial statements so that the public who are not involved in the day to day running of the organization can have some level of confidence in the reported financial position. The willingness of internal auditors to report a discovered breach depends on a number of factors including; the level of independency accorded by the management (Raja, 2002). Audit independence must be viewed within the totality of corporate governance and the accountability of organizations to their stakeholders. The audit Committee must closely monitor the auditor's relationship with the company's management. For this to be done effectively, a membership of the Audit committee is required which together is sufficiently independent of executive management, has a minimum level of financial literacy and has the ability to ask perceptive questions which are pursued diligently (Raja, 2002). Mokono and Nasieku (2018) focused on the factors affecting internal auditors 'performance in public universities in Kenya. The study found out that the internal auditors working environment, internal audit independence and authority, internal auditor's technical competence impacted on the performance of internal audit function.

Statement of the Problem

Financial sustainability in public institutions is concerned with ensuring that funds are continuously available when required and that they are acquired and utilized in the most efficient and effective manner to the advantage of the citizens who are tax payers; but financial sustainability has become one of the most prominent issues (World Bank, 2016). Financial sustainability of public universities in Kenya has various financial challenges. The auditor general's report 2018 revealed that majority of public universities have financial management challenges. The reports indicated that some universities over expend on votes, others do not complete their projects on time, while others make payments without supporting documents. In addition, the reports established that in some cases procurement procedures were not followed, while other universities were unable to fully account for funds allocated. This is an indication that public universities in Kenya have challenges with their auditing practices.

Empirically, studies done both in the global and local context for use of auditing to check financial sustainability have exhibited contextual, conceptual and methodological gaps. For instance, Davidson, Goodwin-Stewart and Kent (2005), Hutchinson and Zain (2009), Messier (2011) and Kaplan and Mike (2014) have focused on general financial auditing in foreign countries without really identifying salient auditing principles areas that requires adequate focus to boost financial reporting and management in either private or public organizations. More interestingly, despite complaints from the public and Office of the Auditor General about financial unsustainability due to financial mismanagement in public universities, most financial audit reports are either politicized or cancelled as malicious and lacking authenticity, yet many public universities in Kenya still complain of financial unsustainability; a gap that motivated this study to investigate influence of auditors independence on financial sustainability in public universities in Kenya; a case of Masinde Muliro University of Science and technology.

Research Objective

The objective of the study was to determine the influence of auditors' independence on financial sustainability in public universities in Kenya.

The study was guided by the following research hypothesis

- **$H_{0:}$** Auditors independence does not significantly influence financial sustainability in public universities in Kenya.

LITERATURE REVIEW

Limperg's theory of inspired confidence

This theory was developed in the late 1920s by the Dutch professor Theodore Limperg (Hayes et al., 2005). Limperg's theory addresses both the demand for and the supply of audit services. According to Limperg, the demand for audit services is the direct consequence of the participation of outside stakeholders in the company. These stakeholders demand accountability from the management, in return for their contribution to the company. Since information provided by management might be biased, a possible divergence between the interest of management and outside stakeholders, an audit of this information is required.

With regard to the level of audit assurance that auditor should provide, (the supply side), Limperg adopts a normative approach. The auditor's job should be executed in such a way that the expectations of a rational outsider are not thwarted. So, given the possibilities of audit technology, the auditor should do everything to meet reasonable public expectations. This theory of inspired confidence is therefore related to this study because it helps assess how auditors should help public universities' financial officials identify and seal financial mismanagement areas so as to boost financial accountability and sustainability.

Auditors' independence
- Appointment of audit service provider
- Accountability of audit oversight committees
- Authenticity of audit reports
- Impartiality of both internal & external auditors

Financial sustainability
- Financial deficits/surplus
- Income statements
- Budget allocations/expenditures
- Total Operational revenues

Independent Variables **Dependent Variable**

Figure 1: Conceptual Framework

This study assessed whether appointment of audit service providers, accountability of audit oversight committees and authenticity of audit reports are done without due influence so as to highlight cases of financial frauds thus influencing financial sustainability of public universities in Kenya.

That is independence is the attitude of auditors who are impartial, do not have personal interests, and are not easily influenced by parties who have an interest in giving opinions (Mulyadi, 2014). Auditor independence is one of the important factors to produce a quality audit. Independence is a determinant of audit quality, because if the auditor is truly independent it will not be affected by his client. The auditor will freely carry out his audit duties. However, if auditors do not have independence, especially if you get pressure from the client, the audit quality that is produced is also not optimal. The auditor cannot provide an objective opinion if he is not independent. Even though auditors have sufficient technical capabilities, the public will not believe if they are not independent.

Alqatamin (2018) found that in response to the financial crises, the Jordanian government established regulations for the establishment of an independent audit committee in 2008 as part of a series of accounting reforms to improve corporate governance practices and restore investor confidence in companies listed on the Amman Stock Exchange (ASE). The government's recommendation to establish an independent audit committee was on a voluntary basis for companies, but in 2013, it was made mandatory for all companies listed on the Amman Stock Exchange.

Dhaliwal (2010) further supported the notion of independent audit committee by asserting that independent audit committee is a good corporate governance mechanism because it includes the quality, credibility, objectivity and integrity of the company's financial report. The audit committee has become an important mechanism in corporate governance, where the board has delegated many important functions, such as supervision of corporate governance and financial report to its standing committees, specifically, and the audit committee. As all members of the audit committee have oversight responsibility of the company's financial reporting process, their characteristics can enhance the effectiveness of the audit committee. Previous studies have concluded that an effective audit committee and its relevance to the quality of the company's financial reporting can reduce the management of earnings, financial fraud and qualified audit reports.

Kamurudin (2013) also asserted that structure and characteristics of audit committees really determine financial reporting in any firm. That is, it was noted that the characteristics of the audit committee are an essential part of governance, as a guarantee that the management is accountable to the shareholders and presents a true and fair image of the company. The role of the audit committee is central to discussions between policymakers, supporters, investors and academics, which include holding regular meetings with external and internal auditors to identify any irregularities in financial reports, assessing risks and evaluating the company's internal control system. This reduces the gap between managers and shareholders by preventing monopoly over information in the administration and ensuring all reports are presented in a timely manner.

Davidson, Goodwin-Stewart and Kent (2005) in their study, sought to find out the link between internal governance structures and earnings management of Australian firms. The governance structures comprised of the board of directors, the internal audit function and external auditors. A sample of 434 firms listed on the Australian stock exchange during the year 2000, was selected and a broad cross- sectional regression analysis was used to test the association among the independent variables and the dependent variable. The researchers concluded that there was no strong linkage between the choice of external auditors and the role of the internal auditors, thus pointing on issues relating to independence of auditors.

Raja (2002) asserted that auditors are used as a mechanism to enhance credibility of the financial statements so that the public who are not involved in the day to day running of the organization can have some level of confidence in the reported financial position. The willingness of internal auditors to report a discovered breach depends on a number of factors including; the level of independency accorded by the management. Audit independence must be viewed within the totality of corporate governance and the accountability of organizations to their stakeholders. The audit Committee must closely monitor the auditor's relationship with the company's management. For this to be done effectively, a membership of the Audit committee is required which together is sufficiently independent of executive management, has a minimum level of financial literacy and has the ability to ask perceptive questions which are pursued diligently.

Caswell and Allen (2001) study further reinforced that Auditor's independence in an organization has been termed as the cornerstone of the auditing profession since their opinion shades light to the management whether the financial statements for a given period depicts a fair and true position of the financial status of the organization (Craswell & Allen, 2001). Auditor's independence could mean that the auditor has full control or influence in the matter of his operation, action, conduct and opinion on his findings (American Accounting Association, 2003).

Locally, Mugo (2008), in his study aimed to determine the scope and independence of internal audit function in the publicly quoted companies in Kenya. The results of the study indicated that the scope of internal audit was not wide enough to cover not only financial data but also the data from other operations of the organization. Independence from operations in terms of objectivity was found to be quite high unlike in terms of organizational status, which was found to be moderately high. The study concluded that the accounting discipline remained the source of internal audit staff and recommended information technology specialists to handle IT based audit systems.

METHODOLOGY

In this study, explanatory survey research design was employed since this design is suitable for exploring associations that are conducted in order to explain any behaviour or reactions of people to a given phenomenon in the society; Peshkin (1990). The target population was 54 staffs who were categorized into Financial Officers, Accountants, Heads of Department and Internal Auditors. The choice of these population units was informed by the roles they play in audit practices and financial sustainability in the university. The study used a sample size of 54 respondents from a target population of 54 respondents. Conventionally, the larger the sample: the smaller the sampling error (Gay, 1992). Primary data was collected by means of self-administered structured questionnaires. The questionnaires were structured and designed in multiple choice formats. 10 copies of the instrument were used during pilot testing for validation. That is, pretesting of research instrument was used to confirm that questions are well written, meaningful and having adequate content so as to ensure content validity. Pilot testing was done and a Cronbach alpha was computed using SPSS version 24. Descriptive analysis such as frequencies, means, and standard deviation was utilized whereas analyzed data presented in tables and graphs. Linear regression analysis was used to determine the influence of independent variable on the dependent variable. The following study statistical model was used:

$y = \beta0 + \beta1X1 + \varepsilon$

y = financial sustainability of public universities in Kenya

$\beta0$ = Constant

X1 = auditors independence

{$\beta0$ & $\beta1$} = Beta coefficients

ε = the error term

FINDINGS AND DISCUSSION

Descriptive Statistics

The descriptive statistics presented in this section were summated responses on the statements measuring the auditors independence using Likert scale with values ranging from 5 to 1; that is; 5=Strongly Agree, 4=Agree, 3= Uncertain, 2=Disagree and 1= Strongly Disagree. The results were presented in the table form showing frequencies of responses as per each statement and its corresponding percentage score in brackets, means and standard deviations. The descriptive results were presented in table 1.

Table 1: Descriptive statistics: Auditor's Independence

Statement	5	4	3	2	1	mean	Std.dev
There is independent appointment of audit service providers that diligently audit university finances	4 (7.8)	22 (43.1)	21 (41.2)	2 (3.9)	2 (3.9)	3.47	0.86
The internal audit committees are not controlled by senior university executives	9 (17.6)	29 (56.9)	10 (19.6)	2 (3.9)	1 (2)	3.84	0.83
There are audit oversight committees that are not micro managed by the office of the Vice Chancellor	9 (17.6)	22 (43.1)	15 (29.4)	4 (7.8)	1 (2)	3.67	0.93
All university financial audit reports are authentic in nature	2 (3.9)	13 (25.5)	25 (49)	8 (15.7)	3 (5.9)	3.06	0.90
Both internal and external auditors operate independently without influence from the office of the Vice Chancellor	6 (11.8)	23 (45.1)	13 (25.5)	7 (13.7)	2 (3.9)	3.47	1.01
Valid listwise 51							
Grand mean = 3.5							

From table 1, most respondents agreed (43.1%) and strongly agreed (7.8%) that there was independent appointment of audit service providers that diligently audit university finances. This was reinforced by 56.9% of respondents who agreed that the internal audit committees were not controlled by senior university executives, thus confirming independence in appointment and micromanaging auditors.

Further, 43.1% and 17.6% of respondents agreed and strongly agreed respectively that there were audit oversight committees that were not micro managed by the office of the Vice Chancellor, while a further 25.5% and 3.9% of respondents agreed and strongly agreed respectively that all university financial audit reports were authentic in nature, implying independence in financial auditing system. Most respondents (45.1%) also reinforced this by agreeing that both internal and external auditors operate independently without influence from the office of the Vice Chancellor.

On overall response, the grand mean was 3.50 rounded to 4 which was 'agree' on the Likert scale of measurement implying that generally, most respondents agreed that auditors independence influence financial sustainability in Masinde Muliro University of Science and Technology. This was supported by Mulyadi, (2014) assertion that auditor independence is one of the important factors to produce a quality audit. Independence is a determinant of audit quality, because if the auditor is truly independent it will not be affected by his client. The auditor will freely carry out his audit duties. However, if auditors do not have independence, especially if you get pressure from the client, the audit quality that is produced is also not optimal. The auditor cannot provide an objective opinion if he is not independent. That is, even though auditors have sufficient technical capabilities, the public will not believe if they are not independent.

Inferential Statistics

Inferential Analysis consisted of linear regression which yield R, R Square, F statistics and regression coefficients. The purpose of linear regression was to the linear influence of auditor's independence on financial sustainability in Masinde Muliro University of Science and Technology. The R value indicated correlation between auditor's independence and financial sustainability while R square indicated changes in financial sustainability that is been accounted for auditor's independence. F statistic revealed whether the model is useful in predicting financial sustainability and regression coefficients predicted changes in financial sustainability as a result of auditor's independence. The results were shown in table 2.

Table 2: Direct influence of auditors' independence on financial sustainability

Model Summary

					Change Statistics				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.828[a]	.685	.682	.69122	.685	172.190	1	49	.000

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	82.270	1	82.270	172.190	.000[a]
	Residual	37.745	49	.478		
	Total	120.015	50			

Coefficients[a]

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
1 (Constant)	.702	.219		3.213	.002
Auditors Independence	.848	.065	.828	13.122	.000

a. Dependent Variable: Financial sustainability

From table 2, R value of 0.824 indicated that there is positive relationship between auditor's independence and financial sustainability of Masinde Muliro University. This implied that increase in auditor's independence would results to increase in financial sustainability. The model summary also showed that $R^2 = 0.685$; implying that 68.5% variations in the financial sustainability in Masinde Muliro University of Science and Technology is explained by auditors independence while other factors not in the study model accounted for 31.5% of variation in financial sustainability in Masinde Muliro University of Science and Technology.

From the ANOVA result, the significance of the model had a value F (1,50) =172.190, P<0.01 which showed that the model is significant 99.0% confidence level. This postulated that auditor's independence is a useful predictor of financial sustainability. Caswell and Allen (2001) study further reinforced that Auditor's independence in an organization has been termed as the cornerstone of the auditing profession since their opinion shades light to the management whether the financial statements for a given period depicts a fair and true position of the financial status of the organization (Craswell & Allen, 2001). Auditor's independence could mean that the auditor has full control or influence in the matter of his operation, action, conduct and opinion on his findings (American Accounting Association, 2003).

Further, coefficient analysis shows that auditors independence has positive significant influence on financial sustainability in Masinde Muliro University of Science and Technology (β = 0.848 (0.065); *at p<.01*). This implied that a single improvement in auditor's independence will lead to 0.848 unit increase in financial sustainability in Masinde Muliro University of Science and Technology. Therefore, the linear regression equation was;

$$y = \mathbf{0.702 + 0.848X_2}$$

Where;

y = financial sustainability in Masinde Muliro University of Science and Technology

X_2 = auditors independence

The study null hypothesis stated that auditor's independence does not significantly influence financial sustainability in Masinde Muliro University of Science and Technology, Kenya. Linear regression results indicated that auditors' independence has significant relationship with financial sustainability in Masinde Muliro University of Science and Technology, Kenya. The null hypothesis was therefore rejected. The results indicated that a single improvement in auditors' independence will lead to significant increase in financial sustainability in Masinde Muliro University of Science and Technology. The results were supported by Alqatamin (2018) who found that in response to the financial crises, the Jordanian government established regulations for the establishment of an independent audit committee in 2008 as part of a series of accounting reforms to improve corporate governance practices and restore investor confidence in companies listed on the Amman Stock Exchange (ASE). The government's recommendation to establish an independent audit committee was on a voluntary basis for companies, but in 2013, it was made mandatory for all companies listed on the Amman Stock Exchange.

Raja (2002) study also asserted that auditors are used as a mechanism to enhance credibility of the financial statements so that the public who are not involved in the day to day running of the organization can have some level of confidence in the reported financial position. The willingness of internal auditors to report a discovered breach depends on a number of factors including; the level of independency accorded by the management. Audit independence must be viewed within the totality of corporate governance and the accountability of organizations to their stakeholders. The audit Committee must closely monitor the auditor's relationship with the company's management. For this to be done effectively, a membership of the Audit committee is required which together is sufficiently independent of executive management, has a minimum level of financial literacy and has the ability to ask perceptive questions which are pursued diligently.

CONCLUSION AND RECOMMENDATIONS

The study concluded that auditors' independence in authentically reporting financial mismanagement significantly influences financial sustainability. If auditors do not have independence, especially if they get pressure from the client, the audit quality that is produced is not optimal, the auditor cannot provide an objective opinion if he/she is not independent and even though auditors have sufficient technical capabilities, the public will not believe audit reports if they are not perceived to be independent. The study recommended that public university finance managers should foster auditors' independence without compromising or conspiring with them, so as to give authentic audit reports that dully identify financial mismanagement. The study recommended area for further research to be done in devolved governments in Kenya so as to compare results and also a study can be done on determinants of audit quality.

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